DRN-3870724

The complaint

A partnership, which I'll refer to as G, complains about a fixed rate business loan which the partners say was mis-sold by Santander UK Plc.

What happened

In 2014, G took out two business loans from Santander, each with a 20-year repayment profile. One was for £570,000 with the interest rate fixed for ten years. The other loan, supported by European Investment Bank (EIB) funding, was for £380,000 with a variable interest rate.

In 2018, G sought increased borrowing to expand its business, but it was unable to agree this with Santander. The partnership refinanced with another lender and incurred a break cost of £48,481 for terminating the fixed rate Santander loan before the end of the ten-year period.

In 2021, G complained to Santander about the original sale of the fixed rate loan, saying that the bank had failed to give the partners adequate information about the features, risks and benefits of the loan, especially in regard to potential costs for early termination.

Santander didn't uphold G's complaint. The partners then referred the complaint to this service.

After considering the evidence, our investigator said that Santander hadn't given the partners sufficiently clear information in 2014 about the potential size of the costs for early exit from the fixed rate. But he concluded that even if the bank had provided all the right information, the partners would still have chosen to enter the fixed rate loan contract. He gave the following reasons, in summary:

- There's no evidence that the bank provided any advice or recommendation at the time of the sale, or that it put any pressure on the customer to take the lending on a fixed rate.

- The loan wasn't a regulated product. But the investigator would expect the bank to have given the customer appropriate information to make an informed decision about taking the loan. He would expect the bank to have communicated in a way that was clear, fair and not misleading.

- The facility letter mentioned the possibility that break costs would be incurred, and there were illustrations of likely break costs in a factsheet and in an email. But none of these gave clear information about the potential size of the break cost for G's fixed rate loan. The factsheet gave information about loans of a size and duration that were different from G's loan, and the email based on G's loan gave an example break cost which was much lower than the actual cost G paid in 2018. So the investigator thought G hadn't been in a position to make an informed decision.

- The investigator thought the stability of known payments for a proportion of its borrowing would have been attractive to the partners, especially as the Bank of England base rate had been as high as 6% in recent history. He wasn't convinced that they had any intention to pay down any part of the fixed rate loan within ten years, and G had variable rate lending that could be repaid at any time without penalty. For these reasons, the investigator thought it likely that even if sufficient information had been provided about the potential break costs, G would still have chosen to fix the rate for ten years.

The partners didn't agree with the investigator's conclusions. On their behalf, their representative said if they'd realised that the break cost could have been as much as £50,000, they would have thought the trade off against stability of payments wasn't worth it.

After considering all the evidence and arguments, I issued a provisional decision in which I said that, for the most part, I'd come to the same conclusions as the investigator, and for largely the same reasons. But I was minded to conclude that if the partners had been fully informed about the potential scale of break costs, they would reasonably have chosen to fix the interest rate for seven years rather than ten. In my provisional decision I explained my reasoning as follows:

> *As preliminary points, I should say that I agree that both loans were unregulated products, no advice was given by the bank, no pressure was put on the customers, and the fixed rate wasn't a condition of lending.*
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> *Having said that, I also agree with the investigator that the information Santander gave about the possible scale of break costs wasn't good enough to enable the partners to make an informed choice.*
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> *I've looked carefully at the documents. The facility letter and the terms and conditions together set out that in the event of early repayment, the customer could face additional costs which "could be substantial." The fixed rate loan factsheet explains the risk in more detail and gives illustrative figures based on a loan of £1m fixed for five years. But G's fixed rate loan was for £570,000 fixed for ten years, so I don't think the factsheet illustration can be said to have given the partners clear information about scale of the break costs associated with their particular loan.*
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> *The partners were also alerted to the break cost risk in an email, which did contain a bespoke illustration for the £570,000 loan fixed for ten years, showing an example break cost of £13,600 for exit at seven years. In the event, when G repaid the loan in 2018, the break cost was £48,481, so again I don't think the email example gave the partners clear information about the potential scale of the break costs.*
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> *For the avoidance of any doubt, I'm satisfied that Santander informed the partners that the fixed rate loan carried a risk of break costs for early exit. But I don't think the bank gave a clear picture of the potential scale of those costs for the particular loan that was sold to G. When the partners entered the loan, I don't think they would have expected to face a fee of over £48,000 to repay their borrowing four years later.*
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> *I therefore need to consider whether the partners would have done anything differently if they'd been fully informed. It isn't possible to be certain what would have happened, so I have to decide what was most likely. I agree with the investigator that the partners would have been attracted to fixing the rate on part of their lending, for the security of predictable repayments and to reduce their exposure to any general increase in rates. I also agree that having about 40% of their Santander borrowing on a variable rate gave them some flexibility to reduce their debt without penalty if the*

need arose. So I agree that it's likely that the partners, had they had a full appreciation of the potential scale of break costs, would still have chosen to enter a fixed rate loan.

The partners acknowledge that, with full information, they might still have taken a fixed rate loan – though they say they wouldn't have agreed to anything longer than five years.

I note that G's borrowing from Santander in 2014 was partly in support of a change in the partners' business. The bank has explained that it was "to facilitate a change in their business operation from beef/sheep farming to primarily dairy (with some sheep remaining)." In terms of business risk, I think this was a substantial change – with products, farming methods, equipment, customers and market mechanisms that were new and different. Arguably it amounted to an entirely new business venture. In the circumstances, I think the partners, with the full knowledge of the potential scale of costs for early termination, would reasonably have considered a ten-year fix to be too long. Given the number of uncertainties, I think a rational view of the new venture would have been that the enterprise would be unlikely to remain the same size for a decade. Depending on the level of success in building the new business, it would have been reasonable to believe G might need to cut back or increase its borrowing, both of which would expose it to possible break cost risks.

In the event, the risk materialised – G did seek to increase its borrowing and, unable to agree additional finance from Santander, broke its fixed rate loan in 2018 and moved to another lender. I'm conscious that it wouldn't be reasonable to use hindsight to determine the risks faced by G at the time it took the lending. But I'm satisfied that there's clear evidence that in 2014 the partners were embarking on a new type of business, and in those circumstances I believe that a full knowledge of the potential break costs would have made them reluctant to fix for ten years.

On balance, I think the partners would reasonably have chosen to fix the interest rate for seven years rather than ten. This would have given the stability and protection of seven years of known regular payments and the knowledge that if the loan had to be broken at, say, five years, the potential break costs would be likely to be far less than with a ten-year fix. I believe a seven-year fix would have achieved a reasonable balance of interest rate protection and flexibility for G's new business operation.

I conclude provisionally that a fair and reasonable outcome of this complaint would be to put G in the position it would have been in if, at the outset, it had taken the £570,000 loan with an interest rate fixed for seven years.

I invited the parties to send me any additional comments or evidence.

Santander disagreed with my provisional decision, saying that the partners had been given a clear picture of the potential scale of break costs. It also said the proposal to shorten the fixed rate period seven years is not supported by the facts. The bank made the following points, in summary:

- The £1m loan illustration was in a standard factsheet. It would be disproportionate and impractical for the bank to produce a bespoke factsheet for every client. It was fair and reasonable to expect a client of G's level of sophistication to review and understand the example given and to apply this to a specific loan.

- The email about the partners' specific loan made it clear that its intention was for the client to "*understand the concept*". It was also made clear that the bespoke break cost illustration was just an example.

- The information given at the time shouldn't be seen through the lens of perfect hindsight.

- The bank doesn't accept that the change to primarily dairy farming was a substantial change to the partners' business.

- Longer-term fixed rates are common in agricultural business and a ten-year term is not unusual.

G too disagreed with the provisional decision. Its representative made the following points, in summary:

- Had the partners been given the correct information about break costs, they wouldn't have taken a fixed rate at all.

- The base rate had not been at 6% "*within recent history*" as claimed by the investigator.

- The committed period given by the bank for the fixed rate loan was ten years, while the committed period for the variable rate loan supported by the EIB was five years. If the EIB and Santander declined to renew or refinance the variable rate loan, it would have been difficult to refinance elsewhere. That might have led to an event of breakage at five years.

- In the interest of compromise, the partners have said they might have taken a five-year fixed rate. The ombudsman's view that the partners would have taken a seven-year fixed rate appears to be offered as a further compromise and does not tie in with the variable rate loan or with the partners' business plan, which indicated they would hopefully be in position to be repaying debt within a three to five year timeframe.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

Having done that, I haven't changed my view from my provisional decision. I'll explain why.

I've already explained above why I think the information Santander gave about the potential scale of break costs wasn't good enough to enable the partners to make an informed choice. I appreciate that banks face a practical challenge in providing satisfactory information on fixed rate and hedging products, given the number of factors involved, but it doesn't change my view. I don't think it was reasonable to expect the partners to make their own calculations to convert the figures in the £1m five-year fix illustration to fit their own £570,000 ten-year fix. Santander's further illustration in the email had the virtue of being tailored to the actual loan, but it gave only one scenario with a relatively comforting break cost of £13,600. I don't believe it helped clarify the potential scale of these costs for the customer.

I agree that agriculture is one of the sectors in which longer-term fixed rates are more common. But that doesn't change my view of the pre-sale information given to the partners.

In my consideration of the choice the partners would have made with better information, I've taken into account the nature and circumstances of their farming business at the time.

I'm not an expert on matters such as milk prices, pasture quality or calving systems, but I still believe that moving from beef to dairy farming was a substantial change for the partners, and that it carried inherent uncertainties about the future scale of their business.

The partners had a business plan, but the trajectory of the new dairy operation would have been subject to many different variables. They faced not only the risk of the business falling short of their expectations, but also the risk of needing to expand more than they had originally planned. I still think it would have been reasonable to believe that G might need to cut back or increase its borrowing, which in either case would expose it to possible break cost risks. In the event, G did seek to increase its borrowing in 2018 and had to break the fixed rate.

I said in my provisional decision that it wouldn't be reasonable to use hindsight to determine the risks faced by G at the time it took the lending. I've therefore considered the situation that G was in at the time the loan was taken. Given the uncertainties about the future of the new business, I believe that a full knowledge of the potential break costs would have made the partners reluctant to fix for ten years.

The partners' representative argues that the overall cost of the fixed rate, including the higher interest rate and the possibility of a break cost, was such a bad bargain that it is hardly conceivable that the borrower would have entered the fixed rate at all. But in my view, the partners were given sufficient information about the price of the fixed rate loan repayments at the time of the agreement, and it was only the information about the break cost risk that fell short of what was fair and reasonable. In my decision, I've addressed what would have happened differently if the partners had been given sufficient information about the potential level of break costs.

The partners' representative is correct to point out that the Bank of England base rate had not been as high as 6% for some years. It was 6% in February 2000. But the base rate was 5.75% between July and December 2007, which was less than seven years before the loan. I therefore think it's reasonable to say that base rate had been close to 6% in recent history. I would add that it was at 5% or above between November 2006 and October 2008. So I'm satisfied that the substantive point remains – that the partners would have known that rates fluctuate and had recently been much higher than they were at the time the loan was agreed. For that reason, I believe it wasn't unreasonable for the partners to seek protection from future increases.

The partners' representative says the possible need to refinance the variable rate loan after five years gave rise to an additional break cost risk – a risk that he says would have led the partners to reject a seven-year fixed rate. Even if the partners had been concerned that the variable rate loan might not be renewed, I'm not persuaded that a seven-year fixed rate would have been outside their risk appetite.

Exiting after five years of a seven-year fixed rate would have led to a break cost of the same order as the example Santander gave in its bespoke email. The partners were content to proceed with the original loan having knowledge of that potential level of break cost, so I believe they would have accepted the same level of risk for a seven-year fixed rate. I therefore don't believe that full information about the break costs, for a seven-year fixed rate, would have deterred them from taking the fixed rate loan, even after considering the risk of refinancing the variable rate loan.

Neither side believes that reducing the term of the fixed rate from ten years to seven years would be a reasonable outcome, though they argue from opposite points of view. The bank argues that it should remain at ten years and the partners argue they wouldn't have taken a fixed rate at all, and certainly nothing longer than five years.

It's not possible to say exactly what would have happened if Santander had given the partners better information about the potential scale of break costs. I therefore have to base my determination of the complaint on what, in my view, is most likely to have happened. G originally chose a product that offered the stability and protection of ten years of known regular payments, which I believe was attractive to the partners for sound reasons. When they made that choice, they knew they faced a risk they would incur break costs if they terminated the loan earlier, though in my view they weren't fully aware of how high those costs could be.

With better information, I believe the partners would still have valued the stability and protection of known regular payments, for as long a period as would have kept the risk within a limit that was acceptable to them. For reasons I've explained above, having noted the break cost risk the partners accepted when they agreed the original loan, I believe that they would have been likely to accept the risks of a seven-year fixed rate. I therefore believe that reducing the fixed rate term from ten to seven years is a fair and reasonable outcome.

Putting things right

For all the above reasons, I don't depart from my provisional decision. I find that a fair and reasonable outcome of this complaint would be for G to be put in the position it would have been in if, at the outset, it had taken the £570,000 loan with the interest rate fixed for seven years.

My final decision

My final decision is that I require Santander UK Plc to put G in the position it would have been in if the partnership had borrowed the same amount of £570,000 with a fixed rate loan, but with the rate fixed for seven years rather than ten years. This should reflect the following practical considerations:

- The replacement lending should run from the original start date in 2014, with the same profile over 20 years.

- The replacement lending should be terminated at the same date in 2018 as the original loan.

- The bank should reimburse any difference in payments, including the break costs, between the existing and the replacement product.

- The bank should add compensatory interest at 8% simple per annum to the reimbursed payments from the date the cost arose to the date of settlement. If the bank believes it's legally obliged to deduct tax from the interest, it should send a tax deduction certificate with the payment.

Under the rules of the Financial Ombudsman Service, I'm required to ask G to accept or reject my decision before 19 January 2023.

Colin Brown
Ombudsman