complaint

C has complained that it was mis-sold a fixed rate loan by Clydesdale Bank Plc ("Clydesdale") in 2007.

background

C is a company involved in property. In 2007, it moved its debt from another bank to Clydesdale. C agreed a 22 year variable rate loan for £144,000, a 22 year fixed rate loan for a further £100,000 and a five year capped rate loan for £100,000.

The fixed rate loan was broken in 2009 when C incorporated this into another fixed rate loan with Clydesdale.

C complained about the sale of these products in 2014. It thought it hadn't been provided with enough information about the fixed rate loan at the time of the sale and had been pressured by Clydesdale. Clydesdale acknowledged that they hadn't properly explained break costs for ending the loan early. But, Clydesdale thought that C, if fully informed, would still have taken a fixed rate loan, but for a shorter five year term.

C wasn't happy with this and brought its complaint to our Service. One of our adjudicators looked at the evidence and thought there should be a full "tear up" of the fixed rate loan so that it was on a variable rate from the outset. He agreed with C that Clydesdale had given the impression that the fixed rate loan was flexible. The adjudicator thought that C wouldn't have agreed to a fixed rate loan had it known that the loan wasn't as flexible as it had been led to believe due to potential break costs. That's because he thought C may have wanted to sell properties and repay debt early. The adjudicator also said that C had preferred variable rate loans for almost all its other debt.

Clydesdale didn't agree with the adjudicator's view. They said there was evidence from 2007 that C intended to retain its properties for the long term. Clydesdale also said that C had taken a balanced approach by having variable, capped and fixed rate lending. As such, it wasn't exposed to a high risk of break costs. So, they thought their offer of reducing the fixed rate loan from 22 years to five years was fair.

I was then asked to make a decision on this matter. Although C has complained about other loans it had with Clydesdale, this decision relates only to the fixed rate loan taken in 2007.

I issued my first provisional decision on this complaint on 8 July 2016. My finding in that provisional decision was that Clydesdale's offer was fair. I said that although Clydesdale hadn't done enough to explain break costs in 2007, I still thought that C would have been attracted to a shorter five year fixed rate loan. I said that C had flexibility in its other lending and had sold a property in 2009 without incurring break costs.

In response, C provided detailed submissions, including submissions from its legal representatives and an adviser. Those submissions related to both C's fixed rate loan from 2007 and 2009. In relation to the 2007 loan, the main points were:

- C ran a property development business, not a property investment business. It was essential that C had the flexibility to buy and sell all property. Clydesdale were aware of this when they recommended the fixed rate loan in 2007.

- Clydesdale advised C to take the fixed rate loan. C was told that the loan was fully flexible, which in reality wasn't the case. Clydesdale also told C that they would look favourably upon future lending requests if C took out a 22 year fixed rate loan in 2007. All recommendations regarding the fixed rate loan flowed from Clydesdale. But for this, C would have stayed on variable rate loans as it had always done. There's no evidence that C would have chosen a five year fixed rate loan in 2007.

- Clydesdale failed to provide evidence that all essential documents were sent or received by C ahead of the fixed rate loan or that C understood the contents of those documents.

- There's no evidence that C would have chosen a five year fixed rate loan in 2007. In fact the strategy paper that was allegedly sent to C in 2007 suggests that a five year fixed rate was actively rejected at the time. And the rate for the five year fixed rate loan was higher than the rate for a 22 year fixed rate loan and so this would have been less attractive to C.

- The sale of one of C's properties in 2009 should have no bearing on the complaint. That's because that property was the subject of a short term development loan and wasn't held as security for the fixed rate loans. C didn't have flexibility to sell its other three properties which were the subject of fixed rate lending.

- C has now seen Clydesdale's internal bank records and listened to the trade calls. It was very concerned that a note from 2007 doesn't accurately record discussions held at the time between the bank and C's director. C's view was that this showed that Clydesdale's evidence about the sale of the 2007 loan is unreliable and inconsistent.

- C's director provided several character references.

I asked Clydesdale to comment on C's submissions. They said C was provided with a product profile for the fixed rate loan in 2007 which showed that there could be substantial break costs for the fixed rate loan. They reiterated that Clydesdale didn't recommend or otherwise advise C to take the fixed rate loan in 2007. Clydesdale also explained that they thought that their internal records were accurate.

I wasn't persuaded by C's submissions and issued a second provisional decision on 23 February 2017 again setting out that I thought Clydesdale's offer was fair for similar reasons as in my first provisional decision.

In response, C made more submissions. In addition to those it made previously, the submissions can be summarised as follows:

- C reiterated that it hadn't received important product information. C wouldn't have known to ask Clydesdale for product information it hadn't received as it wouldn't have had any idea about what documents Clydesdale had a duty to provide in the first place.

- The rate for a five year fixed rate loan was higher than for a 22 year fixed rate loan. It wouldn't have agreed to this as it was looking to reduce its borrowing costs at the time.

- Clydesdale have breached their terms and conditions for the fixed rate loan by not having in place a mirrored hedge with a third party and should not be able to recover any break costs for C's loans.

my findings

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

I'd like to assure C and its representatives that I've looked at all of their submissions with care. In this decision I concentrate on the key arguments and evidence that are material to my determination of the complaint.

Having done so, I've not been persuaded to change my provisional decisions.

was C pressured or advised by Clydesdale?

I don't doubt that Clydesdale were keen to sell C the fixed rate loan. But I haven't seen any compelling evidence that Clydesdale unfairly pressured C. It looks like C was told to look at interest rate movements for the previous 30 years before the sale to show the value of taking a fixed rate. Whilst this may have emphasised the volatility of interest rates and that they could go very high, I don't think it was necessarily wrong for Clydesdale to do this. C was after all considering taking a long term loan and so looking at long term historical rates may have been helpful. And, at the time, no one knew that interest rates would in fact drop after 2008 and remain low for a considerable amount of time.

The loan facility which was signed by C in 2007 also made clear that Clydesdale hadn't provided advice. I accept that the fixed rate loan was agreed after the general loan facility. But, I haven't seen evidence that Clydesdale provided advice to C in the intervening period.

what information was provided by Clydesdale

Even though they didn't provide advice, Clydesdale still had to provide C with enough information for it to make an informed choice in 2007. I think it's likely that C understood the basic features of how the fixed rate loan worked. I think it knew the loan meant that it would pay a fixed amount of interest throughout the term of the loan. Fixing rates can often be attractive for those involved in property because it provides known outgoings against rental income. I think the fact that C took a very long 22 year fixed rate loan is evidence that it was attracted to this feature.

C says that Clydesdale misrepresented the fixed rate loan as a flexible product. It has provided a copy of a generic leaflet Clydesdale provided to it in 2007 called "*Protect your cash flow against interest rate risk*". This does suggest that Clydesdale's range of tailored business loans offered flexibility if the customer's views of interest rates changed.

Clydesdale say they sent some more detailed product information to C about break costs if the loan was ended early. But, they've accepted that this information didn't explain the break costs in as much detail as it should have. And, although Clydesdale have pointed out that C's director had been an Independent Financial Adviser, I don't think he had knowledge of break costs and how they are calculated. Looking at all the evidence, I don't think C would have understood just how large break costs for the fixed rate loan could be.

are the records and evidence provided by Clydesdale reliable?

C has questioned the accuracy and authenticity of Clydesdale's internal records. C has also said that it didn't receive product information from Clydesdale before it agreed the fixed rate loan. I can't be certain about this. But, looking at all the evidence, I think it's likely that Clydesdale did send this to C's director by post. There's email correspondence to support this.

C has asked me to allow it to conduct forensic analysis of the email communications from the time of the sale to establish whether they were sent and received. However, I don't think it's reasonable for me to do that in this case. We provide an informal service and I'm only required to make a decision on what I think is most likely to have happened. I'm satisfied that I can do this without digital forensic evidence.

In any event, I think it's important to stress that my decision doesn't turn on whether or not C received product information or the accuracy or Clydesdale's records in this respect. It's not in dispute that the product information didn't fully explain the risk of break costs even if this had been sent to C in 2007. So, I've based my decision on what I think C would have done if it had been fully informed. And I think the crucial question here is whether or not I think C needed full flexibility in its lending.

did C require full flexibility?

C has said that the break costs for a 22 year fixed rate loan would have hindered its key requirement for flexibility. I agree that it's unlikely that C would have committed to the fixed rate loan for such a long period of time if it had been fully informed about break costs. But, I don't think this would have been as critical to its decision making in 2007 for a shorter five year fixed rate loan.

C has said that it was a property developer and not a property investor. But I think the material factor is whether or not I think C intended to dispose of its properties in the short term and end the fixed rate loan. I've seen no compelling evidence to show that this was the case. So I don't think C would have thought that there was a high risk of break costs within five years of 2007.

Importantly, even if I accept that C may have thought that it would sell properties in the short to medium term, I think it could still repay debt without the risk of break costs. That's because it had a substantial amount of lending on variable and capped rates. In other words, I agree with Clydesdale that C had taken a balanced approach in 2007 when it agreed the fixed rate loan in conjunction with the other two loans it took at the same time. I think further evidence of this is that, in 2009, C did sell a property and repay debt without incurring any break costs for its fixed rate lending.

I appreciate that C had previously taken variable rate loans with another bank and in fact took variable rate loans with Clydesdale after 2007. C says this is evidence of its preference for variable rate lending. However, in the particular circumstances of this case, I think this gives greater weight to my view that a fixed rate loan for part of its debt wasn't restrictive to C's business plans. It still had flexibility to take other variable rate loans. And, as I've said above, I don't think C would have agreed to fix rates for 22 years if it had no interest in protecting itself against interest rate rises for some part of its debt.

I know that C did incur break costs of around £16,000 when it re-structured its lending in 2009. But I don't think C would necessarily have anticipated ending the loan early at the time it agreed the fixed rate loan in 2007. This cost was blended into the interest rate for its new loan in 2007. And the break costs for a five year loan are likely to have been lower than £16,000.

Clydesdale have offered to replace the 22 year loan with a five year fixed rate loan instead. I think that's fair because a five year fixed rate loan would have allowed C to benefit from fixed rates, without being exposed to the risk of break costs for too long. Clydesdale have said that a five year replacement won't result in compensation to C because it would have had a higher fixed interest rate than the longer 22 year loan. Clydesdale have also said they will adjust the interest C paid for the further loan it took in 2009 to reflect the revised break cost for the shorter five year fixed rate loan. Again, I think that's fair.

I've noted that the fixed rate for a five year loan is higher than for the 22 year fixed rate loan that C agreed in 2007. But interest rates hadn't significantly fallen by 2007 and so I remain of the view that the five year rate of 6.40% would have been attractive, particularly as C had other variable and capped rate lending too.

Clydesdale's terms and conditions for recovery of break costs

C has said that it shouldn't be liable for any break costs to Clydesdale. It says the bank's terms and conditions set out that break costs are only recoverable as a liability incurred by the bank for having to break a mirrored hedging arrangement that it has entered into with a third party which it then passes on to its customer. However, C says that a Clydesdale representative has now accepted that there is in fact no mirrored hedging arrangement with a third party and that the bank only hedged internally with the National Australia Bank ("NAB") which is part of the same Group as Clydesdale. C says there is a court case which decided that internal breakage costs such as this are not recoverable by a bank.

I've considered this argument carefully. But, having done so, I don't agree with C for the following reasons:

- It's clear that the court case quoted by C is very fact specific. It focusses on the wording of a loan agreement of another bank.

- Clydesdale have clarified that although there is no "mirrored" hedging arrangement with a third party, NAB entered into arrangements with third parties to hedge all of the Group's (including Clydesdale's) sterling interest rate risk.

- Most importantly, Clydesdale's terms and conditions relating to break costs are wide ranging and not limited to the recovery of costs associated with any related hedging arrangement. Under clause 8.2, any loss, cost or liability incurred by Clydesdale or its affiliates in connection with the following can be recovered from the customer:

  (i) *maintaining or funding the Hedged Facility;*
  (ii) *taking such action as we or our Affiliate may think fit to preserve the economic equivalent of payments that we would otherwise be entitled to receive from you under the Loan Documents in respect of the Hedged Facility or the Hedged Loan;*
  (iii) *the termination, closing out, cancellation or modification of any Hedging Arrangement; and/or*

(iv) liquidating or re-employing deposits from third parties acquired or contracted for in order to fund the Hedged Facility.

- I've seen an explanation of estimated break costs as at December 2015 for the loan C took in 2009. In summary, the estimate was calculated by reference to the total cash flow Clydesdale would have received from the fixed rate loan if it were not broken against the sum of money it would receive (based on predicted market conditions) if the loan was repaid early and the bank were to apply those funds elsewhere. I think this in line with sub clause (ii) set out above.

Taking this all into account, I don't think I need to establish whether or not there was only an internal hedging arrangement applied to C's loans or the details of any external hedging done by Clydesdale or NAB. And I don't think it would be fair or reasonable for me to conclude that Clydesdale can't recover break costs from C under its loan agreements.

other matters

C has said that it's incurred legal fees in bringing the complaint and safeguarding its legal position. It thinks Clydesdale should pay for this. The ombudsman offers a free and informal service to resolve disputes. We decide whether the bank has handled the complaint fairly by looking at the facts of the case – not at how well the complaint is presented. So we don't usually require a bank to pay a customer's costs for professional help in bringing their complaint here.

However, C has referred to its costs in entering a standstill agreement. I do accept that C needed to protect its legal position and had to enter into a standstill agreement to ensure it wasn't time barred from taking action in the courts. I've looked at the bill of costs C has provided from its solicitors. It looks like it directly paid around £1,000 for the drafting of the standstill agreement. It's likely that the standstill agreement was put in place for C's complaints about four of its loans and so I think this cost should be split across the complaints about those loans. But, I also appreciate that further fees are likely to have been incurred in obtaining instructions from C and liaising with Clydesdale about each of the loans. So, overall, I think it's reasonable to apportion £400 to account for the drafting and other work required for the standstill agreement for the fixed rate loan taken in 2007. I think it's fair for Clydesdale to pay this sum.

summary

I fully sympathise with C and I understand the strength of feeling in this matter. Clydesdale didn't do what they should have done in 2007 by providing full information about the risks in ending the fixed rate loan. However, I have to make my decision on what I think C is most likely to have done had it been fully informed. And I think it's fair and reasonable to conclude that it would have taken a shorter fixed rate loan.

my final decision

My decision is that Clydesdale Bank Plc should replace the 22 year fixed rate loan that C took in 2007 with an equivalent five year fixed rate loan. Clydesdale have said that C would have ended up paying slightly more each month for the replacement product but that they won't ask C to pay this additional amount. I think that's fair.

Clydesdale should make adjustments to the break fees C paid in 2009 by an appropriate reduction in the interest rate C paid for the new 2009 loan. Clydesdale should also pay C £400 for its legal fees.

Under the rules of the Financial Ombudsman Service, I’m required to ask C to accept or reject my decision before 5 June 2017.

Abdul Hafez
ombudsman