complaint

A company, N, has complained that they were mis-sold an interest rate swap by Barclays Bank Plc in June 2007, and suffered various losses as a result.

background

N operates in the secondary lending market: essentially it borrows from banks and lends to other businesses at a profit. In early 2007 its directors approached Barclays for a loan of £550,000 to enable a management buyout. The request was initially sanctioned by the bank on 14 February 2007.

In March 2007 N's buyout team agreed in principle to protect at least £500,000 with a hedging product. On 27 March 2007, the buyout team met with the bank's representatives to discuss the available hedging options, as the company preferred not to pay any premium for hedging. In return for hedging, N negotiated a reduction in the bank's lending margin and a repayment holiday.

Barclays sent N two sets of presentations at different times in April showing how an interest rate swap worked and current pricing. These showed five, ten and 15 year terms. In May, following those discussions, Barclays' relationship manager submitted a revised credit sanction for N, showing them paying a reduced lending margin of 1.75% if hedged.

On 29 May 2007 the bank issued facility letters for three separate loans in accordance with the original credit sanction, under which there was no hedging condition. N signed and returned the facility letters accepting these offers.

The management buyout was completed, and the loans, set at 2% above base rate, were drawn on 27 June 2007. On the same day the buyout team took part in 'a trade call' with the bank. During the call the buyout team committed N to a ten year swap at 6.32% effective immediately. The swap would match the value of the £500,000 total loan for the first year repayment holiday, then amortise to £197,003.98 by the end of the ten year period in June 2017.

On 28 June 2007 the bank sent N a confirmation which two of the directors involved in the company buyout signed. The next day the bank sent N three separate letters of variation amending the terms of the loans. This included reducing the lending margin to 1.75% above base rate; confirming the repayment holiday of 12 months and setting the hedging conditions.

In all cases the hedging product had to be acceptable to Barclays.

Following the fall in base rate, N started paying the bank under the terms of the swap contract. The overdraft facility of £50,000 became strained. Two directors decided to support N by lending it funds. £55,000 has been lent, of which £5,000 has been repaid. A flexible loan agreement was completed between two directors and N on 22 February 2011. This stated:

1. N would repay a minimum of £1,000 per month from 1 April 2011. Interest would be calculated at 5.5% gross; and

2. N could make additional repayments at any time without penalty.

N says that, had the swap payments not been debited from its account, the overdraft would have been available to fund day-to-day business expenses. Therefore N would not have had to borrow from the directors and pay them 5.5% gross interest which works out at £5,772.99 (as at end-October 2013) which N is claiming as a consequential loss.

The adjudicator investigating the complaint provided two opinions on the case.

The first opinion related to the sale of the swap, which the adjudicator upheld, mainly because he felt that the bank had not properly made N aware of the potential for very large break costs. The adjudicator explained that N had two options:

1) to remain hedge free, and pay the bank a 2% lending margin on the loans or;

2) to hedge £500,000 for ten years, and pay the bank a reduced 1.75% lending margin on the loans.

This being the case, the adjudicator felt that N effectively chose a lower lending margin in the hope that base rate would remain at/above the 6.32% fix, without being in possession of sufficient facts to allow the company to make a fully informed decision.

The bank accepted the adjudication in part, but not the proposed redress of reconstructing N's accounts as if there had been no hedge at all. Barclays made a counter-proposal which involved restructuring N's accounts with a five year swap. N asked for an ombudsman to consider their case.

The second opinion related to the consequential loss. The adjudicator did not uphold this part of N's complaint. He did not think that there was a direct link between the sale of the swap and the consequential losses claimed. Dissatisfied with the adjudicator's opinion on consequential losses, N asked for this part of the complaint to be considered by an ombudsman as well.

my findings

I have considered all the available evidence and arguments to decide what is fair and reasonable in the circumstances of this complaint. When considering what is fair and reasonable, I am required to take into account relevant law and regulations; regulator's rules, guidance and standards, and codes of practice; and, where appropriate, what I consider to have been good industry practice at the time.

I have also taken into account the 'relevant considerations' and key questions set out in the decisions on the W Family's complaint about Bank E and Business H's complaint about Bank S, which have been published on our website at:

http://www.financial-ombudsman.org.uk/publications/technical.htm#investment.

I am therefore satisfied that the key questions I would normally need to ask are:

- whether hedging was a requirement of the loan being negotiated with N;

- whether Barclays gave N information that was clear, fair and not misleading to enable it to make an informed choice about the swap; and

- whether Barclays gave N advice about the interest rate swap (and if so whether the bank took adequate steps to ensure that the advice was suitable).

However in this case I am satisfied that there are some aspects which are no longer in dispute.

liability not in dispute

Neither Barclays nor N have asked me to re-consider the adjudicator's conclusion that the bank provided insufficient advice to N to enable it to make an informed choice about the swap. Indeed Barclays has said in their response to the adjudication:

"It acknowledges that there were some shortcomings with the sale of the Swap and its own internal investigations … suggests that [N] did not receive sufficient breakage costs information to enable it to reach a fully informed decision to enter into the Swap."

It's worth stating for the record that I agree that the bank certainly gave insufficient information, and in particular about the break costs and the potential size of them if N wished to exit early from the swap. If these had been adequately explained, I do not think N would have entered into a ten year swap for £500,000.

On the same basis, that the bank has admitted insufficient information has been provided, I do not find it necessary for me to consider further whether Barclays did or did not provide advice to N. I say this because even if I did conclude advice was given, it would still lead me to consider what N may have done differently. I have already reached that stage as there is no dispute that insufficient information was provided.

what might N have done differently?

My aim, in the broad sense, when deciding a complaint and, if necessary, awarding any redress is to place the complainant in the position they would have been in if the bank had not made errors.

I accept that I cannot know with any certainty what that position would be, particularly given the time that has passed since 2007. I have therefore made a decision based on what I consider to be a fair and reasonable outcome.

It is important to remember that N only chose to hedge on the basis that Barclays would reduce its lending margin from 2% to 1.75%. Within the space of one month, N, who had by that stage signed and agreed a loan facility paying 2% over base rate, agreed to vary the agreement. They signed up to an interest rate swap for the majority of the loan in return for a reduction of 0.25% in the lending margin.

As a secondary market lender, N's business model is all about maintaining its competitive edge at the lowest possible cost. I can't see that if N had had the information about the costs of breaking the swap, they'd have wanted to enter a swap agreement at all.

The transcript of the trade call shows the director negotiating the swap with Barclays thinking of the risk of interest rates falling to *"2% or something stupid".* If it had been explained to them that as interest rates fell, the attractiveness of the swap package decreased and their break costs would have increased sharply, I am satisfied that N would have made the simple economic decision not to proceed.

N had already opted for the higher lending rate so I am satisfied that the original deal was completely acceptable to them.

The adjudicator proposed a complete tear-up of the swap and Barclays made a counter offer. I have reviewed that offer but I am not persuaded by Barclays' reasoning. They argue that the director negotiating the swap had an employment history which would suggest he was comfortable with the language of hedging products. This is disputed by N. I also didn't see that to be the case when I reviewed the transcript of the trade call, and other correspondence on the file. Barclays has suggested that as N was a lender of small loans, it would be used to highly complex financial products. I am not of the same view.

Barclays is concerned that in tearing up the swap, N will receive a disproportionate benefit. I don't agree. In fact they will be put in the position they would have been in if there had been no variation to the original loans they agreed with Barclays. As Barclays has stated, N was not provided with information *"to enable it to reach a fully informed decision to enter into the Swap"*.

consequential losses

When this service reviews claims of consequential loss, we need to be persuaded that the loss is a direct result of the issue in dispute. I have considered the facts presented to us by N but I would need to make a number of assumptions for this to be the case.

Firstly, there is the secondary lending market in which N operates. Due to the recent economic crisis, it is completely feasible that N would have had other trading factors to manage and may have had to write off a number of bad debts. This being the case, an injection of funds may always have been required.

The nature of the company's business model is that it is always on the look-out for opportunities to re-lend funds at a higher rate. It could be argued that directors lending funds (for those then to be re-lent at a higher rate) is a legitimate business exercise as are the costs that go with that.

I am not satisfied that the interest that N has paid is wholly as a result of the payments N had to make for the swap, and therefore am not upholding this aspect of the complaint.

other issues

During the course of N's complaint, a number of other issues have been raised:

- the ability of the director involved in negotiating the swap to commit N;
- hedging not being included in the loans offered on 29 May 2007; and
- one of the director's instruction that his personal guarantee was not to be linked to any interest rate product.

These were all considered within the adjudication of 3 September 2013. I can understand why the directors of N wished to raise these initially but neither N or Barclays has added anything further to be considered.

I am satisfied that there is no requirement on me to add anything further, particularly as none of these issues have a material impact on the decision I am making.

my final decision

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £150,000, plus any interest and/or costs that I consider appropriate. If I consider that fair compensation exceeds £150,000, I may recommend the business to pay the balance.

Determination and award: I partially uphold the complaint. My decision is that Barclays Bank Plc should reconstruct N's accounts to put them into the position they would have been in had they not hedged at all - up to a maximum of £150,000.

To achieve this, Barclays Bank Plc's reconstruction of N's relevant accounts should take into account the following:

- the rate for the three loans, totalling £550,000, should be set at 2% above base rate as demonstrated by the facility letters of 29 May 2007. This should also be the lending margin on the loans moving forward;

- Barclays should reconstruct and refund all payments made towards the base rate swap that resulted in any rates or fees being charged by Barclays;

- If the reconstruction results in Barclays returning payments to N, it should refund any interest or fees incurred by the company as a result of these payments;

- If Barclays believes that is it legally obliged to deduct tax from the interest, it should send a tax deduction certificate with the payment.

Recommendation: If the amount payable in respect of this reconstruction exceeds £150,000, I recommend that Barclays Bank Plc pays N the balance.

This recommendation is not part of my determination or award. It does not bind Barclays Bank Plc. It is unlikely that N can accept my decision and go to court to ask for the balance. N may want to consider getting independent legal advice before deciding whether to accept this decision

Sandra Quinn
ombudsman