Financial Ombudsman Service

complaint

C has complained that it was mis-sold a fixed rate loan by Clydesdale Bank Plc ("Clydesdale") in 2009.

background

C is a company involved in property. In 2009, it restructured its debt. At the time, its loan arrangements with Clydesdale included the following:

- a 22 year variable rate loan for £144,000 taken in 2007;
- a 22 year fixed rate loan for £100,000 taken in 2007;
- a five year capped rate loan for £100,000 taken in 2007;
- a 10 year "modified participating fixed rate loan" (MPFRL) for £500,000 taken in 2008.

All these loans were incorporated into a new fixed rate loan C took with Clydesdale in August 2009. This was a 14 year loan for £1,200,000 and fixed interest at 5.12% (an all-in rate of 6.766%).

In 2014, C complained about its loans with Clydesdale. It thought it hadn't been provided with enough information about the 2009 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 it thought that the fact that it had offered to settle C's complaint about the MPFRL with a replacement cap needed to be taken into account. It said the settlement assumed the cap at 5.9% for £500,000 would still be in place and wouldn't have been incorporated in the 2009 loan. The 2009 fixed rate loan would therefore be for £700,000 with a cap for the remaining £500,000 up to 2018. Clydesdale said this reduced the risk of C incurring break costs. So, Clydesdale thought that C, if fully informed, would still have taken a fixed rate loan in 2009, but for a shorter five year term and for £700,000.

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 argued that C's director was also a former Independent Financial Adviser ("IFA") and so had a better understanding of hedging products. Clydesdale also said C decided to fix rates despite considering more flexible options. Clydesdale reiterated that the MPFRL had been converted to a cap up to 2018 and so C would have benefitted from additional flexibility in 2009. So, they thought their offer of reducing the fixed rate loan from 14 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 2009.

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 and that they should put C in the position it would be in if it had fixed rates for £700,000 for five years instead of the 14 year fixed rate loan for £1,200,000 it took in 2009, with the remaining £500,000 subject to a cap up to 2018. I said that although Clydesdale hadn't done enough to explain break costs in 2009, I still thought that C would have been attracted to a shorter five year fixed rate loan for £700,000. I said that C would have had had flexibility with its other lending and had sold a property in 2009 without incurring break costs.

I invited both parties to provide any further evidence and arguments that they wanted to be considered before I made my final decision.

C provided detailed submissions, including submissions from its legal representatives and an adviser. Those submissions relates to both C's fixed rate loans from 2007 and 2009. In relation to the 2009 loan, the main points can be summarised as follows:

- C ran a property development business, not a property investment business. It was essential that C had the flexibility to buy and sell property. Clydesdale were aware of this when they recommended the fixed rate loan in 2009.

- 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. 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 2009.

- 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.

- Break costs were discussed in 2009. But C was told that they were nothing to worry about. C was also told that the bank couldn't give it any idea of the magnitude of the break cost which might be incurred during the "forced" restructure in 2009. This was wrong. The bank's representative knew how much C had incurred, £76,000, and deliberately withheld this from C as he knew that this would deter C from taking a new fixed rate loan. The break cost of £76,000 was higher than C's annual rental income at the time of £62,000.

- Email correspondence showed that the bank's representative earned a huge undisclosed commission of around £23,000 for recommending the restructure of all of C's debt into one fixed rate loan in 2009. This was evidence to support C's assertion that the 2009 sale was a forced sale.

- 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 held as security for the 2009 fixed rate loan.

- C couldn't have sold any of its other three properties after 2009 because of the loan to value covenant in its loan. That would be the case even if the fixed rate loan was for only £700,000 rather than £1,200,000. So, C would have taken variable rate or capped rate lending in 2009 to avoid break costs.

- C would have taken a variable rate loan in 2009 if it had been fully informed. And if it did want interest rate protection, it would have taken a cap and not a fixed rate loan. C doesn't think Clydesdale have calculated the cost of the cap premium fairly when it now says that it would have cost around £30,000 for a cap at 5.9% for £700,000 of its debt. In any event, C could have afforded a cap in 2009 especially as C would have been financially better off but for the mis-sale of the MPFRL which Clydesdale had separately agreed to provide redress for.

- 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. Another note from 2009 said that break costs had been discussed on the deal call with C's director when it was clear from the recording of the call that this didn't in fact happen. C's view was that this showed that Clydesdale's evidence about the sale of the loans in 2007 and 2009 is unreliable and inconsistent.

- The monthly payments quoted to C on the deal call from 2009 don't match the payments that C in fact made to Clydesdale following the sale. The amount C paid was around £10,000 per year higher. C thinks this is because the break cost blended into the 2009 loan is larger than Clydesdale will now admit.

- C's director provided a number of character references.

Clydesdale agreed with my first provisional decision and also provided me with further information. In summary, Clydesdale said C was provided with a product profile for the fixed rate loan in 2009 which showed that there could be substantial break costs for the fixed rate loan. Clydesdale didn't recommend or otherwise advise C to take the fixed rate loan in 2009.

C had been discussing various hedging options with the bank in 2009, including having some debt on a capped rate but decided to fix rates for all its debt.

Clydesdale explained that they thought that their internal records were accurate. They also said that the fact that C paid more each month for the loan in 2009 than the price quoted on the trade call was because the quote didn't take into account the total borrowing that C was subjecting to the new fixed rate loan. They said the amount that C ended up paying each month was in line with what C had previously been quoted as evidenced by the fact that C has never queried this previously. Clydesdale said the additional amount wasn't because of an undisclosed break cost.

After reviewing all these arguments, 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.

- C provided evidence that it had reached an agreement in principle for the sale of one its properties in 2012. It said the sale didn't proceed because of the break costs for the 2009 loan. C said this supports its argument that flexibility was critical to its business model.

- 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 decision. I still think it's fair to put C in the position it would be in if it had fixed rates for £700,000 for five years with the remainder subject to a cap.

was C pressured or advised by Clydesdale?

C was first introduced to fixed rate loans by Clydesdale in 2007. I don't doubt that Clydesdale were keen to sell C the fixed rate loan again in 2009. And it does look like the bank representative earned a commission or bonus for the sale of the 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 in 2007 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, even though interest rates were low in 2009, no one knew that rates would remain low for a considerable amount of time.

The loan facility that was signed by C in 2009 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 had to provide C with enough information for it to make an informed choice in 2009.

I think it's likely that a range of options, including keeping some of its debt on variable rate terms was discussed with C in the period before the sale. An email I've seen appears to confirm that a meeting took place and product information about the options was sent to C by way of email attachments.

C has said that it didn't receive the email attachments from Clydesdale. I can't be certain about this. But, looking at all the evidence, I think it's likely that Clydesdale did send product information to C. I don't think it's likely that C would have received emails but without attachments and not queried this.

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 14 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. C's director has confirmed that he saw the terms and conditions which said that break costs for the fixed rate loan could be substantial. But he says a Clydesdale representative told him that they were nothing to worry about.

Clydesdale have accepted that the information they provided 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. So, 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. It also doesn't look like C was informed about break costs (around £76,000) that it had actually incurred in 2009 when it restructured its existing loan arrangements and agreed the new loan.

C has questioned the accuracy and authenticity of Clydesdale's internal records. C has also 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. I accept that the product information didn't fully explain the risk of break costs even if this had been sent to C in 2009. 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 14 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 2009 for a shorter five year fixed rate loan for £700,000.

The key point is that break costs would only have been a risk if C thought that it might end the loan early. In other words, was flexibility within five years crucial to C? I don't think it was.

C had previously told us that the sale of one of its properties in 2009 showed that flexibility was crucial to it. C has now explained that it was able to sell the property without paying break costs because this property wasn't security for the fixed rate loan. I think this shows that C anticipated selling this property and retained the flexibility to do so despite the fixed rate loan. And although C says this wasn't a deliberate strategy to avoid break costs for that property, it does show that C had a degree of flexibility in its lending arrangements.

I appreciate that C says it was a property developer and not a property investment company. C had only three properties held as security for the fixed rate loan. These appear to be properties providing a stable rental income. Since my second provisional decision, C has also provided some evidence showing that it agreed in principle to sell two properties in 2012. C may well have wanted to sell these properties in 2012. But, importantly, I'm not persuaded that C firmly anticipated selling any of these properties within five years and repaying debt early when it first took the loan in 2009. And, as I've said above, there was another property that C did intend to sell in 2009 and it went ahead and did this without incurring break costs.

I think it's also fair to say that C would also have had some flexibility from the replacement cap for £500,000 that has been put in place by Clydesdale for the mis-sold MPFRL. So, C's lending in 2009 would have consisted of £500,000 on a cap and £700,000 (not all £1,200,000) on a fixed rate loan.

But, C has said that this cap wouldn't have given it flexibility to sell a property. It says this is because the loan to value ratio covenant in its loan facility and the value of its properties would still have prevented it from selling a property without also ending the fixed rate loan for £700,000 and incurring break costs. Clydesdale disputes this and says the ratio of debt on the sale of a property would be unaffected no matter what the combination of C's interest rate hedging products.

I can't be sure about what the correct position is. However, even if I accept that C would have had to restructure debt, I don't think it's likely that C intended to sell any of its properties within five years for the reasons I've already explained. And a cap for £500,000 would still have allowed C to benefit from lower rates for some of its debt.

I'm also not convinced that flexibility of the new loan structure was as important to C as having fixed loan outgoings. Interest rates had fallen significantly in 2009 and there was uncertainty about whether rates would rise sharply again. Although the prevailing rate was less than 1% at the time of the sale of the fixed rate loan, they had been almost 6% a year earlier. I think C would have been aware of this and that's why it was attracted to having a fixed rate loan despite it being for a rate which was much higher than the prevailing rate and despite having taken variable rate loans in the past.

would C have taken a cap for all of its lending?

C has said that it would have taken a cap for all of its lending in 2009 if it had known about break costs for fixed rate loans. It's not clear whether C had the means to pay for a cap for £700,000 of its lending. But, even if it could, I think it's reasonable to assume that C wouldn't have foreseen that rates would generally remain low during the term of the fixed rate loan. And if rates went higher than the fixed rate on offer, C would have to pay a higher rate as well as the cap premium. So, I don't think C would have thought that it would be worth paying for a cap for the whole of the amount of its lending in 2009.

C had also taken a capped rate loan in the past. So it was reasonably familiar with this type of product. If it had been interested in a cap in 2009, I would have expected to see more evidence of this from the time.

what if C had known about the break costs it did in fact incur in 2009 when restructuring its existing debt?

I know that C did in fact incur break costs of about £76,000 when it took the fixed rate loan in 2009. £60,000 of this was for the mis-sold MPFRL in 2008 and £16,000 for the 22 year fixed rate loan that C took in 2007 which was also mis-sold. It looks like these costs were "blended" into the fixed rate of interest that was agreed for the 2009 loan but C wasn't aware of this at the time. C says it wouldn't have agreed to another fixed rate loan if it had known about this in 2009.

But C has already been compensated for the break costs for the mis-sold MPFRL. And the break costs for the 2007 loan are likely to have been lower for the five year replacement loan that I've said is fair in a separate decision.

In any event, these break costs were blended into the rate that C agreed in 2009 and I think C was satisfied with the fixed rate of 5.12%. The fixed rate for a shorter five year fixed rate loan for £700,000 would have been 4.07%. I think this would have been even more attractive to C in 2009. So I don't think the break costs for the 2007 loan would have deterred C from taking a shorter fixed rate loan in 2009.

did C pay too much for the 2009 loan?

C says it has now discovered that it has been paying more for the 2009 loan than the price it was quoted in the deal call. Clydesdale says the price C has paid is correct and the representative on the deal call had simply made an error.

The price quoted to C on the deal call was clearly wrong. But, I'm satisfied that the price C ended up paying each month is likely to have been accurate even though it didn't match the deal call. After all, C has never queried this previously. And I don't think there's any compelling evidence that the higher amount represents a further hidden undisclosed break cost.

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.

should C receive any further compensation?

C has said that it is being encouraged by Clydesdale to refinance its loan to another bank. It says if it does this, it will incur significant re-financing costs. It thinks Clydesdale should pay these costs. That's because it says re-financing now is more expensive than if it had re-financed in earlier years which it would have done but for the mis-sale of the fixed rate loan in 2009. But C would have had to incur costs for re-banking regardless of whether the fixed rate loan from 2009 had been mis-sold. And I've already explained why I think C would have been satisfied with a five year fixed rate loan in 2009. So, I disagree that it would be fair and reasonable for Clydesdale to meet C's costs for re-financing.

C has also asked me to direct Clydesdale not to transfer its debt to another bank. Provided that it is able to do so under its legal and contractual duties, I think any decision to transfer the debt is a matter for Clydesdale exercising its commercial discretion. In any event, that transfer hasn't yet taken place and so I don't think it would be right for me to make a decision about this as part of this complaint.

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 2009. 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 between 2007 and 2009 by providing full information about the risks of interest rate hedging products and there were a number of mis-sales. However, I have to make my decision on what I think C is most likely to have done in 2009 if everything had happened as it should have. And I think it's fair and reasonable to conclude that it would have taken a shorter fixed rate loan for £700,000 with the remainder subject to a cap.

fair compensation

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 that the business pay the balance.

This recommendation won't be part of my determination or award. It won't bind the business. It's unlikely that C can accept my decision and go to court to ask for the balance. It may want to consider getting independent legal advice before deciding whether to accept my decision.

In order to compensate C, Clydesdale should replace the 14 year fixed rate loan that C took in 2009 with a 5 year fixed rate loan for £700,000 and the remaining £500,000 on a variable rate, subject to a cap at 5.9% until April 2018. To do this Clydesdale should

- Pay C the difference between what it actually paid and what it would have paid if it had instead had the replacement cap and fixed rate loan products I've set out above.

- Pay C compensatory interest of 8% simple per year on any overpayments from the date they were made to the date compensation is paid.

  If Clydesdale believe they are legally required to deduct tax from this interest, it should send a tax deduction certificate with the payment. C may then be able to reclaim any tax overpaid from HMRC, depending on the circumstances.

- Clydesdale should also pay C £400 for its legal costs.

my final decision

determination and award: Clydesdale Bank Plc should carry out the steps specified in the fair compensation section above – up to a maximum of £150,000 plus interest on that amount.

recommendation: if the fair compensation award exceeds £150,000, I recommend that Clydesdale Bank Plc should still carry out in full the steps I've specified above and also pay the balance plus interest on the balance.

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