complaint

C is a farming partnership. The partners complain that they were mis-sold a fixed rate loan by Lloyds Bank PLC.

background

In August 2008, C took out a 25-year fixed rate loan with Lloyds. It was for £1,017,000 and the all-in annual interest rate was 6.47%. This consolidated three previous loans and an overdraft, along with some new lending.

The loan was restructured in 2012 to allow C an extended interest-only period.

In October 2014, C repaid the loan and moved to another lender. To leave the loan early, C had to pay a break cost of £285,242.79.

The partners complained to Lloyds about the break cost, saying that the loan was mis-sold. The bank didn't agree. The partners referred the complaint to us.

Our adjudicator investigated the complaint. He recommended that Lloyds should put C in the position that it would have been in if the interest rate had been fixed for only five years. This included refunding the break cost. He gave these reasons:

– The product literature explained how the fixed rate would work. He thought C would have understood it. The literature also explained that break costs would be payable if the loan was repaid early.

– But it didn't give enough information for C to understand how large the break costs could be. It said they might be 'substantial'. The bank gave an example, for a smaller loan, of a break cost of £4,415. The adjudicator didn't think Lloyds gave C enough information to make an informed decision about the loan.

– He believed that if the bank had given enough information, C would still have fixed the interest rate but for a shorter term, to avoid the potential risk of break costs. He thought it reasonable to conclude that a five year term would have been more suitable.

Lloyds didn't agree that C would have fixed its interest rate for only five years. It made a number of points, including:

– Sufficient weight needs to be given to the fact that C is an agricultural customer. It is almost unheard of for an agricultural customer to take such a short term view.

– The evidence on file shows the customer was motivated by long-term business strategy and by reducing the rate on its lending.

– C had other long-term borrowing elsewhere, including six fixed rate loans with terms over 30 years.

C and its accountant made these further points:

- The length of the lending agreements – fixed or variable – was to make monthly repayments affordable.
- From the start C wanted its borrowing to be approximately 50% fixed interest and 50% variable.
- No alternatives were offered to the fixed rate loan and the scale of the redemption charges were never pointed out. The funding was needed urgently.
- All parties, including the bank, were aware for many years that C owns a field for which planning permission for housing is expected. It's therefore likely that a considerable amount of borrowing will be discharged. In these circumstances, why fix for such a long period?

Lloyds has told us that the fixed interest rate for the replacement loan proposed by the adjudicator would have been 0.385% higher than the original.

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've reached the same conclusions as the adjudicator, for much the same reasons.

I agree with the adjudicator that Lloyds didn't give C enough information about what it could cost to leave the loan early. So the issue I must decide is what C would have done if it had been properly informed.

The partners argue that they would have preferred a variable rate loan all along. But I think other evidence indicates they were content with a fixed rate. It seems they had several weeks to consider the bank's written proposal. The literature about the fixed rate itself was clear, and C was already familiar with fixed rate borrowing. And much of its business planning was, as the bank says, long term. In the circumstances – given that C wasn't informed of the risks – I think that fixing the borrowing rate would have seemed attractive.

But the partners would've seen it differently if they'd appreciated how large the break costs could be. I think a long-term fix wouldn't have been attractive with full knowledge of the risks.

I accept that agricultural lending is often long term. But I have to take into account the specific risks of the product that was offered to C. After careful consideration, I don't believe C would have knowingly accepted the risk in fixing long-term. Although I think C would have agreed to borrow over a long term (to keep its monthly costs down), I believe it would have fixed the rate for a much shorter term (to avoid break cost risks). So I conclude that the replacement product should be a 25-year loan with the interest rate fixed for the first five years.

C had other fixed rate borrowing, but that doesn't change my view. I've seen no evidence that the partners understood the early exit risks at the time they took the Lloyds loan.

my final decision

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 bank to pay the balance.

determination and award: I uphold this complaint because I don't think Lloyds provided enough information about break costs. I consider that fair compensation requires Lloyds Bank PLC to carry out the steps I specify below. I order the bank to do this - up to a maximum financial effect of £150,000.

recommendation: If the financial effect of my award exceeds £150,000, I recommend that Lloyds Bank PLC still carry out in full the steps I specify.

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

the specified steps

Lloyds Bank PLC should put C in the position it would have been in if it had taken its loan over the term agreed, with the first five years on a fixed rate and reverting to a variable rate after this. This should reflect the following practical considerations:

- The replacement loan should run from the original start date.
- The all-in fixed interest rate should be 6.855%.
- The lending should be restructured in 2012, on the same basis as actually happened. Therefore the fixed rate would have been broken and the bank can account for any break costs which would have been incurred at this time. This should be done by either adding these costs to the lending and a new one year fixed rate (at the appropriate rate) taken out, or alternatively the bank can use the break costs to amend the rate applicable to a new one year fixed rate.
- From August 2013 the lending will be on the bank's standard variable rate plus agreed margin detailed in the loan agreement.
- The bank should reimburse any difference in payments between the existing and the replacement product during the five year term. If the payments on the five-year product are more than for the 25-year product, the bank can offset this against any losses.
- The bank should refund the break cost of £285,242.79 incurred on 21 October 2014.
- 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 C to accept or reject my decision before 2 November 2015.

Colin Brown
ombudsman