

## **complaint**

D complains that it was mis-sold a swap by National Westminster Bank Plc (NatWest) in October 2008.

## **background**

I issued my provisional decision on this complaint on 3 February 2016. The background and circumstances to the complaint and my initial finding, which was to uphold the complaint, were set out in that provisional decision. A copy is attached and forms part of this final decision.

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

D reiterated that it thought that it would have taken a cap had accurate pricing been made available to it by NatWest. It provided its expert's opinion on what caps at various strike rates might have cost. D said that although the caps attracted large premiums, it could have paid this in instalments over the term of the cap.

NatWest also responded to my provisional decision. In summary, they said:

- D's director had been involved in two high value swaps with other companies. He was an astute businessman. He was capable of negotiating the swap deal for D and knew the rate he wanted to get. D's director had indicated in one of the calls for the swap with a related company that he understood how break costs worked and that they were market related. Taking these circumstances into account, NatWest had provided D with enough information for it to make an informed decision.
- Achieving the lowest rate possible was D's main concern. It was looking to pay below 5% for as long as possible and was aware of the additional risk that NatWest's callable option added. D didn't think rates would fall or remain low for a long period of time and so the potential size of the break costs was irrelevant to him.
- D clearly wanted to enter into a long term swap as evidenced by the fact that it wanted to fix for 15 years and not just 10 years. D was also told by NatWest that this would create an additional exposure of more than £200,000. This would have given D an indication of break costs that could be involved in long term swaps.
- It wasn't certain that a 5 year swap would have been agreeable to NatWest at the time.

## **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 taken into account D's director's previous involvement with swaps with other companies. I don't doubt that he was aware that break costs were market linked. But I don't think NatWest have provided any persuasive evidence that he knew how large break costs could be. I'm also not convinced that any previous swaps experience had given him extensive swaps knowledge in 2008. That's clear from the deal call where the NatWest representative had to explain some basic practical aspects of the swap he was agreeing. So, I haven't

changed my view that D made its decision to take the swap without being fully informed about the risks involved in ending it early.

I accept that D was very rates focused and wanted to achieve below 5% for as long as possible. It's not unusual for customers to want the cheapest rates. But throughout the period in which swaps were being discussed, D was assessing rates without knowing about the break costs. NatWest have now confirmed that the rate for a 5 year swap would have been 5.07%. Had D been presented with all the right information, I think the 5 year rate would have been close to enough to its desired aim to have been attractive. I also think that NatWest would have been content to offer this to D as it looks like they gave D quotes for 5 year products in 2008.

But, I don't think there's enough evidence from the time that D would have been willing to pay a high premium for a cap. As I've already said, D was looking to achieve the best rates and I think cost would have been a factor, even if the premium was added to the loan. So, in the particular circumstances of this case, I think it's fair to conclude that D would have agreed the premium free 5 year swap. I think it's likely that D would have considered this to provide the protection against interest rates rises that it wanted in the medium term, but without the risk of very high break costs that a 10 year callable swap could entail.

For these reasons, I don't depart from my provisional decision.

### **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 D 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.

### *the specified steps*

NatWest should put D in the position it would have been in if it had taken an equivalent 5 year swap – instead of the 10 year callable swap it actually took.

NatWest should therefore:

- Pay D the difference between what it actually paid and what it would have paid if it had instead had an equivalent 5 year swap.
- Absorb any break costs for ending the existing swap arrangement early.
- Pay D compensatory interest of 8% simple per year\* on any overpayments from the date they were made to the date compensation is paid.

\*If NatWest believes it's legally required to deduct tax from this interest, it should send a tax deduction certificate with the payment. D may then be able to reclaim any tax overpaid from HMRC, depending on the circumstances.

**my final decision**

*determination and award:* I uphold D's complaint and require National Westminster Bank Plc to carry out the steps specified in the fair compensation section above – up to a maximum financial effect of £150,000 plus interest.

*recommendation:* if the financial effect of any award exceeds £150,000, I recommend that National Westminster Bank Plc still carry out in full the steps I've specified above.

Under our rules, I'm required to ask D to accept or reject my decision before 11 April 2016.

Abdul Hafez  
**ombudsman**

## **copy of provisional decision**

### **complaint**

D complains that it was mis-sold a swap by National Westminster Bank Plc (NatWest) in October 2008.

### **background**

D is a limited company. In March 2007, it took out a 2 year loan with NatWest for £1,400,000 secured against rental properties D owned. It restructured the debt in 2008 so that the loan period was extended until 2013. Interest was charged at 1.1% above the NatWest's base rate.

Between February and October 2008, NatWest and a director of D discussed hedging products. NatWest say this was because hedging was condition of the loan, but D now says this wasn't made clear at the time.

In October 2008, D agreed a 10 year callable swap fixing LIBOR at 4.85%. D's aim in fixing against LIBOR was to make gains on the potential difference between LIBOR and the NatWest's base rate. NatWest had the option to cancel or "call" the swap after 5 years and every quarter thereafter.

In 2013, NatWest agreed to extend D's loan to October 2014 with a lending margin of 3% over LIBOR. So, at this point both the loan and swap were linked to LIBOR.

NatWest reviewed the sale of the swap under its agreement with the Financial Conduct Authority. They said that the sale of the swap met the required standards. So, they didn't think that any compensation was due to D. D was unhappy with this and brought his complaint to our service.

One of our adjudicators looked at the evidence. He thought that NatWest may not have given D enough information about break costs of the swap. But he didn't think D would have done anything differently even if it had been given more information. So he didn't uphold the complaint. As D didn't agree with this, I've been asked to make a final decision.

### **my provisional findings**

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

D has said that there was no formal condition of lending that a hedging product also be taken out. But, the director of D recalls that he was told verbally by NatWest that hedging was a condition of the loan extension in 2008. I've also seen reference to this in an email from August 2008.

This service is usually satisfied that making hedging conditions such as this are within a bank's commercial discretion. D could have looked elsewhere to restructure the loan if it wasn't happy with this. And, there's no strong evidence that NatWest pressured D. So, I'm satisfied that both parties knew that the loan had been agreed on this basis and that D was aware it had to take a hedging product.

I don't think there's evidence NatWest provided advice to D. So, I've looked at whether it provided enough information for D to make an informed choice about which hedging product to take out.

I can see that NatWest presented D with a range of products. These related to different kinds of swaps and a collar. But it's not clear whether a cap was also presented to D. This is what D now says was the most appropriate for it. It's also not clear that break costs to end the swap early were explained to D in enough detail. The presentation material is very generic and no examples of possible costs are provided to D. They said only that *"there may be a cost to terminate or restructure the swap early depending on the prevailing market conditions"*. NatWest have said that D's director

had knowledge of hedging products from arrangements with his other companies. But I haven't seen enough evidence that this experience would have given him an understanding of the potential break costs involved in a 10 year swap. Overall, I think the information presented to D wasn't as clear as it should have been.

As a result, the key question I've considered is whether D would have done anything differently had NatWest provided all the right information. It's not possible to be certain about this. So, I have to decide what I think is most likely.

Given the tenor of the discussions and D's aim to minimise costs, I don't think it would have agreed to a cap which would have involved a potentially large premium. The swap D took out was a complex product. However, based on the evidence I've seen, I agree with our adjudicator's view that it's likely that the director of D understood how the callable swap worked and was attracted by the rates offered. Detailed discussions appear to have taken place over a long period of time. I accept D's point that the telephone calls appear to be from NatWest updating D about the rates available for different types of swap. But, I would have expected there to have been evidence from 2008 that D's director didn't understand the swap if that were the case.

I can see that the 10 year swap was weighted in favour of NatWest because it could "call" or cancel the arrangement after 5 years and every quarter thereafter. I think D's director understood that the fixed rate D was getting was lower because of the callable nature of the swap and the number of call options that the bank had. That's why he decided not to move the point at which NatWest could first call the arrangement to 7 years.

But, D couldn't end the swap if the markets moved unfavourably without incurring break costs. I think this was significant because D was hedging against a 5 year loan. I think it was likely that D wouldn't need to hedge beyond 5 years when the loan ended. So, the 10 year swap meant that D was over-hedged. I understand that when the loan ended, the swap could have been used against other debt. But I haven't seen enough evidence that this was a key consideration for D in 2008. As such, had they been explained properly, I think break costs would have been an important factor for D.

The evidence shows that D thought that rates were going to be higher after 5 years and that NatWest would want to break the swap at that point. D didn't envisage a situation where it would want to break the swap early. But I think it would have given more thought to the latter scenario if it had known about the potential break costs that could be involved.

I know D sought to fix the swap rate for an even longer term – 15 years – but this was refused by NatWest. I think this is more evidence that D wasn't making an informed decision as the break costs involved would probably have been even more if D tried to end the swap early if markets moved against it. In other words, if D appreciated the potential magnitude of break costs, I don't think it would have suggested this.

I accept that rates for a straight 5 year swap are likely to be slightly higher than a 10 year callable swap. But, for the reasons I've set out above, if D had known about the break costs that could be involved, I think it's more likely that it would have agreed to a 5 year LIBOR swap and not the 10 year swap it took.

### **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 D 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.

*the specified steps*

NatWest should put D in the position it would have been in if it had taken an equivalent five year swap – instead of the 10 year swap it actually took.

NatWest should therefore:

- Provide details of the rate for an equivalent 5 year LIBOR swap.
- Pay D the difference between what it actually paid and what it would have paid if it had instead had an equivalent five year swap.
- Pay D compensatory interest of 8% simple per year\* on any overpayments from the date they were made to the date compensation is paid.

NatWest should set out its calculation for the above compensation in response to this provisional decision.

\*If NatWest believes it's legally required to deduct tax from this interest, it should send a tax deduction certificate with the payment. D may then be able to reclaim any tax overpaid from HMRC, depending on the circumstances.

**my provisional decision**

*determination and award:* I intend to uphold D's complaint and require National Westminster Bank Plc to carry out the steps specified in the fair compensation section above – up to a maximum financial effect of £150,000 plus interest.

*recommendation:* if the financial effect of any award exceeds £150,000, I intend to recommend that National Westminster Bank Plc still carry out in full the steps I've specified above.

Abdul Hafez  
**ombudsman**