

complaint

C – a limited liability partnership – complains, with the help of a representative, that Clydesdale Bank Plc mis-sold it a fixed rate loan. Amongst other things, it says that the fix was not suitable for its needs, the break costs were not properly explained and it was not clear whether or not hedging was a condition of the lending.

background

C had a telephone interview with Clydesdale in August 2010. The telephone notes describe the conversation had. These set out that:

"We were offering to lend £ 2,125,500 over a 10 year term with qly [sic] repayments.

[Complainant's name] had already decided that they would cover 50% probably on a 5 year fixed rate. We discussed standalone derivatives but his preference was to keep matters simple. An LLP was to be set up that would own the property.

[Complainant's name] was of the view that rates were as low as they could go and now was the optimum time to lock into attractive rates, the only issue he had was that there were plans to repay the loan facility early. His own projections however were that fixing 50% for 5 year would give him the mix that he was looking for together with the flexibility he required.

We discussed other periods to fix and other option [sic] including the Fixed Rate Flexible Maturity. We also discussed caps, range rates and modified participators – he however had a preference for a simple fixed rate loan."

On 19 August 2010, Clydesdale sent C an email. This said, amongst other things, that:

"Further to our conversation yesterday please find attached a brief paper outlining our discussions on protecting the interest rate payable on your new loan. I've also attached an example cash flow together with product profiles."

The attached summary of the conversation C had with the bank confirmed:

- *You are unsure about interest rate levels over the next few years, and appreciated the opportunity to discuss the impact on your business funding.*
- *There is a possibility that you may wish to accelerate payments under this loan arrangement. If this is the case I would suggest that you leave a portion of the loan on floating rate or repay at the end of the "hedged" term.*
- *You are attracted by the known level of the repayments over a fixed rate period.*
- *With Fixed Rate loans (and other loans with a structured "hedge") there is always the possibility that repaying early or amending the terms of the loan could result in an additional cost – please read the attached explanation.*

The letter went on to describe various hedging options and terms of fixes.

In the summary at the end of the letter, the bank confirmed:

"We also discussed the implications of breaking or amending the terms of the loan and the effect that this will have on fixed rate loans. I have therefore included a detailed breakdown of how these potential economic costs are calculated."

The product profile briefly describes break costs as follows:

"Once the facility has been drawn, any subsequent changes to the loan parameters may incur a Break Cost. The amount of Break Cost payable is dependent on market interest rates at the time of making any changes. These costs may be substantial. Break Costs are explained fully in the Tailored Business Loan – Terms and Conditions."

A Facility letter was issued on 23 August 2010 for £2,125,500. This was signed on 24 August 2010.

On 9 November 2010, another facility letter was issued. This was for the same amount.

On 2 February 2011, Clydesdale sent C a confirmation letter for the fixed rate loan. This refers to a phone call between the parties on the same day when the terms of the loan were agreed. The letter set out the terms of the fixed rate loan including the length of the fix and the interest rate payable. A confirmation letter for the variable rate lending was sent on the same day. Both of these letters included schedules which set out the payments due throughout the course of the loans.

During the deal call the parties had on that day – a recording of which has been made available to us – C was asked to confirm that the terms of the loan were as agreed and that break costs had been discussed with it, which it did on both accounts.

C complained about the sale of the loan sometime after the end of the fixed term. In August 2016, Clydesdale issued its final response. It did not uphold C's complaint.

Clydesdale concluded that C was willing to accept the risk of paying break costs for the benefit of protecting itself against potential rises in interest rates. Whilst it recognised that C may not have fully appreciated the potential magnitude of break costs, it thought that C would have taken out the fix over the same term regardless.

This is because:

- There is no indication that C intended to or was likely to repay the loan before the end of the fix.
- The terms of the fix were not incompatible with C's circumstances or business plans at the time.
- C understood the difference between fixed rate and variable rate lending. And that its payments were fixed throughout the fixed term, regardless of any movement in interest rates.
- The loan ran its course and was repaid after the fixed rate period. There is no evidence that C sought to repay or change its lending during the course of the fix. And no complaint was raised during that time or following the fix coming to an end.
- The loan was classed as commercial lending and the sale was non-advised.

Unhappy with this response C referred its complaint to our service.

Our adjudicator reviewed the complaint and was of the view that it should not be upheld. In summary, he concluded that:

- The terms of the loan and the various options available to it were made clear to C;
- It chose to fix half of its lending for five years and leave the rest on a variable rate to allow it to make over payments;
- C would have understood that it may have to pay break costs but he thought that C may not have fully appreciated how break costs work or the impact these may have; but
- He didn't think that better information would have changed C's mind;
- C did not complain until after the fixed term ended and there is no evidence that it attempted to repay the loan early;
- Whilst Clydesdale may not have entered into a specific third party hedging arrangement in respect of this loan, he did not think that this amounted to a breach of the terms and conditions of the loan – and, in any case, he noted that the loan was not repaid early, so break costs were never incurred.

C disagreed; because agreement could not be reached the case was passed to me for review.

I sent C and Clydesdale my provisional decision on 26 July 2018, explaining why I didn't think the complaint should be upheld. I explained that I would consider anything either party wanted to add as long as I received it by 26 August 2018. Neither party responded with anything to add, so I have no reason to depart from my provisional findings. I have reiterated these below.

my findings

I've considered all the available evidence and arguments to decide what's 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 codes of practice; and what I consider to have been good industry practice at the time.

The parties to this complaint have provided detailed submissions to support their position. I thank them for taking the time to do this. I have considered these submissions in their entirety. However, I trust that they will not take the fact that my decision focuses on what I consider to be the central issues as a courtesy. The purpose of this decision is not to address every point raised in detail, but to set out my findings and reasons for reaching them.

C has raised concerns about it not having been made clear whether or not hedging was a condition of the loan and that Clydesdale failed to properly assess the suitability of the fixed rate loan. I have not seen anything that would lead me to conclude that C was incorrectly led to believe that hedging was a condition of this lending. And, I am not persuaded that the transaction was advised – or, that Clydesdale was obliged to undertake a suitability assessment under the circumstances.

Looking at everything I have been provided, in particular the evidence I have referenced above. I think that C understood the basic terms of the loan it took out and the options that were available to it at the time of the sale. It also seems that it elected to take out half of its

lending on a five year fixed rate and retain half on a variable rate to provide itself protection against fluctuations in interest rates whilst retaining some flexibility.

I think that C would have been aware that there would be break costs, if it chose to refinance or repay the loan before the end of the fixed term, and that these could be significant. I am not, however, persuaded that the information provided was clear enough for C to understand the potential magnitude of the break costs that may be payable on its loan, depending on applicable interest rates at the time and other prevailing economic factors.

The fact that I have found that Clydesdale failed to give C clear enough information about an important feature of the fixed rate loan does not automatically mean that the complaint should be upheld. I have to consider what, if anything, C would have done differently if it had been given sufficiently clear information. Having done so, I think that in this particular case, it is more likely than not that C would have taken out the loan on the same terms. I will explain why.

I think that at the time of the sale fixing the rate of interest payable on the loan would have been an attractive proposition. It would have provided C some security in knowing what it would have to pay during the course of the fix. Taking into account the sum borrowed and the term of the loan, I can see why C would have thought that this was a good idea.

It is important to note that whilst interest rates have been at historically low levels in recent years I cannot look at this with the benefit of hindsight. And, at the time of the sale, I don't think that this was foreseeable. In fact, given the economic volatility experienced around that time, I think that the security of being protected against rises in interest rates would have seemed like a beneficial attribute of the loan.

This is not to say that fixing the interest rate came without its own risks. C may have had to pay break costs if it needed to pay the loan back early or refinance. And, it could not have taken advantage of a drop in interest rates without refinancing and having to pay the aforementioned break costs, which could have been substantial.

So, I have thought about whether or not either of these risks were likely to have deterred C from taking out a fixed rate loan had it been better informed. I have not seen anything that leads me to think that C would have seen the risk of not being able to take advantage of drops in interest rates as significantly outweighing the benefits of fixing the interest rate payable on the loan – particularly taking into account when the loan was taken out. In fact, I think that some thought was given to whether or not C required flexibility across its lending and the implications fixing the rate could have on this – that appears to be why half of its lending was retained on a variable rate.

In summary, I think that C understood the term of the fix and that break costs could be charged in certain circumstances. I also think that C understood that these could be significant. And C went ahead with the lending with that knowledge. Overall, I have not seen enough to persuade me that better information about the potential break costs would have changed C's decision.

Breach of contract

C has suggested that the fixed rate loan should be null and void because Clydesdale breached the terms of the loan, specifically clause 8.1. This clause is contained within the section that covers break costs.

“8.1 Acknowledgement.

You acknowledge that in order to provide you with a Hedged Facility we or any of our Affiliates will have entered into an arrangement with a third party to hedge our risk to fluctuations (a “Hedging Arrangement”) on the assumptions that:

- (a) you will utilise the Hedged Facility strictly in accordance with any Requests; and*
- (b) you will make payments to us strictly in accordance with your obligations under the Loan Documents.”*

Clause 8.2 goes on to describe the circumstances in which break costs may be payable and the costs/liabilities these may be levied to cover, amongst other things, this says:

“...you will pay to us on demand an amount equal to any loss, cost or liability which we determine that we or any of our Affiliates suffers or incurs as a result of the occurrence of those events including, without limitation, any loss, cost or liability suffered or incurred by us or any of our Affiliates in connection with.

- (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.*

Any such loss, cost or liability is referred to in the Loan Documents as a Break Cost Calculation.”

The quoted clauses are wide ranging and allow for Clydesdale to recover costs other than those associated directly with any related hedging. Equally, I don't think they gave rise to an obligation on Clydesdale to enter into a mirrored hedge specifically in relation to the fixed rate loan. In any case, this loan ran to term so no break cost was incurred by C and there is no evidence that C ever attempted to break the loan. So, in this particular case, I don't think I need to make a finding as to whether or not Clydesdale was *in theory* entitled to charge C a break cost.

C has suggested that the contract should be null and void. It is my understanding that the loan ran its course and was repaid at the end of the fixed rate term as intended. So, C borrowed money from Clydesdale, had use of those funds and repaid these in line with terms of the loan – terms which, as I have set out above, I think C would have understood the basics of, such as what it had to pay and for how long. Under the circumstances, I am not persuaded that this aspect of C's complaint be upheld.

my final decision

For the reasons set out above, my final decision is that I do not uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask C to accept or reject my decision before 22 October 2018.

Nicola Curnow
ombudsman