

complaint

H is a limited company and complains that it was mis-sold an interest rate hedging product by National Westminster Bank Plc ("NatWest").

background

H borrowed from NatWest to buy commercial properties. The company had an initial loan in 2005, but it was restructured in November 2006 to a £680,400 loan for 21 years. In December 2007 there was an additional loan of £322,493 for 19 years.

During 2007 there were discussions between the bank and H about using a hedging product to protect the company from interest rate rises. In March 2008 the company agreed a base rate swap with a rate of 5.24% for five years. It was for a notional amount of £1 million, reducing over time.

There was an administrative problem with the loan repayments. As a result, overpayments were taken, so at the end of 2009 the bank reimbursed H by adjusting one of the loans. At about this time, the bank also arranged for the regular swap payments to be taken from the loan accounts rather than H's bank account, and for the original swap to be divided into two – a separate swap for each loan. The swap rates remained the same, as did their end dates, within a few days.

H complained that the swap had been mis-sold. NatWest carried out a review of the swap under its agreement with the Financial Conduct Authority, but it didn't uphold H's complaint. H referred its complaint to this service.

Our adjudicator concluded that NatWest hadn't given the company enough information about the potential costs of leaving the swap contract early. But he didn't think the bank needed to pay H any compensation. He gave these reasons:

- There was no evidence that the company, at the time it signed the swap agreement, was looking to repay the loans within five years.
- The bank's internal notes about a meeting with the company's representatives said that H was looking to grow its commercial portfolio. So even if the loans were repaid early, the swap protection would be transportable to other lending. The company also owned other property.
- He believed the bank adequately explained the general effect of fixing the interest rate using a swap.
- The swap provided protection from interest rate rises, while its five year term was unlikely to limit the company's flexibility.

H didn't agree with the adjudicator's conclusions. Its representative made these points:

- It wasn't correct that H was looking to expand its commercial portfolio. The loans were raised mainly so that the company could buy two properties out of the company pension fund, to give the fund greater investment flexibility. H isn't a stand-alone property investment company.

- The bank initially suggested three variable rate loans, to be drawn down in stages and then restructured into a single fixed rate loan. This would have negated the need for a swap. Because of changing economic conditions, the third loan wasn't drawn down. In the later presentations by the bank, no mention was made of the option of taking a fixed rate loan.
- NatWest knew some flexibility was required. One of the properties was to be newly let, so the bank accepted it may take time to find a tenant. It agreed a deferral of capital repayments for an initial year, which was later extended to two years.
- No price was given for an interest rate cap and no information was given for the option of a fixed rate loan. If H had been given all the required information, it would have either accepted the risk of interest rate rises and taken a variable rate loan, or opted for a cap or fixed rate loan.

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'm sorry to tell H that I've reached the same conclusion as the adjudicator.

I agree that NatWest explained how the swap worked. I believe that H understood that the swap effectively fixed the interest rate on its borrowing for five years. But I also agree that the bank didn't explain the potential break costs properly. What I have to decide is what H would have done if it had been given enough information.

The company used the loans mainly to purchase properties. There had been discussions about a further purchase, though in the end that didn't happen. Even if H wasn't planning to buy more properties at the time of the swap deal, the company seems to have had no plans to sell the existing ones. H anticipated a delay in finding a tenant for one property and the repayment schedule was adjusted accordingly – but I think that was just good planning, rather than an indication of uncertainty in H's plans. I believe that in 2008, H would have seen the predictability of its interest payments as more important than the flexibility to exit from the loans in less than five years.

H's director has said that the swap meant the company suffered enormous financial losses, because there was a substantial fall in general interest rates while the company continued paying 5.24% plus lending margin. But H knew from the start that the swap operated to keep those costs level. I can appreciate that it was upsetting to miss out on the unexpected fall in interest rates, but H knew all along that its borrowing costs would be fixed for the five years.

The company's loan repayments were, for a period, higher than expected – but then the bank made a correction for the overpayments, so in the end H didn't suffer a loss.

H's representative says that with better information H would have given more consideration to a cap or a fixed rate loan. It's difficult to know exactly what would have happened, but I think the cost of the premium for a cap would have been unwelcome to H at the time. And it's unlikely that H would have been able to move its lending elsewhere to a fixed rate loan without the risk of break costs similar to the swap. At an earlier stage, NatWest had mentioned consolidating the loans and fixing the rate – but in my view the bank was talking about its hedging products, not about fixed rate commercial lending without potential break costs.

On balance, and taking all the circumstances into account, I think that if the company had been properly informed about the scale of the potential break costs, it would still have gone ahead with the five-year swap.

my final decision

For these reasons, my final decision is that I don't uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask H to accept or reject my decision before 9 July 2015.

Colin Brown
ombudsman