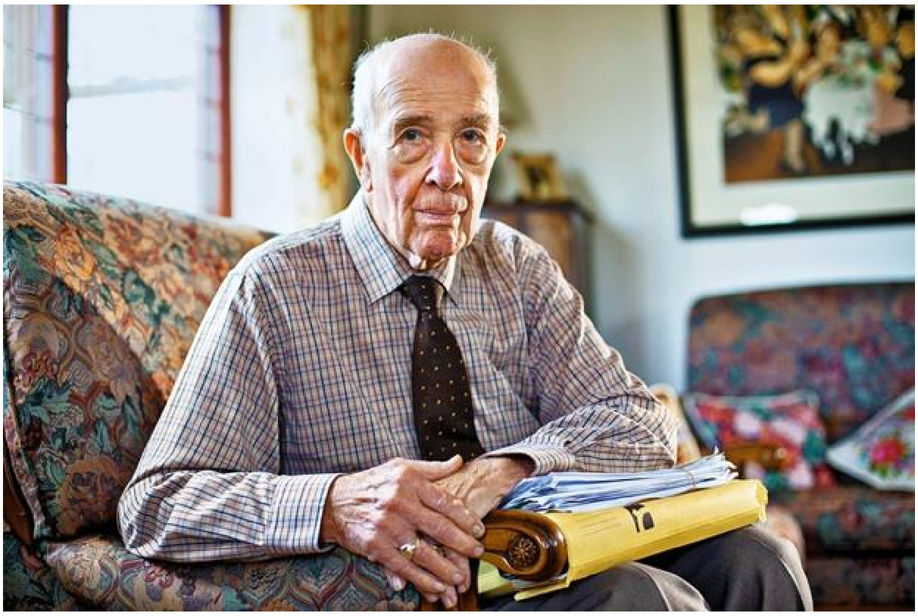
THE TIMES

Spotlight falls on watchdog over swap deals mis-selling



Businessman Doug Wardle with documents relating to his eight-year mis-selling battle with the Royal Bank of Scotland Newsteam

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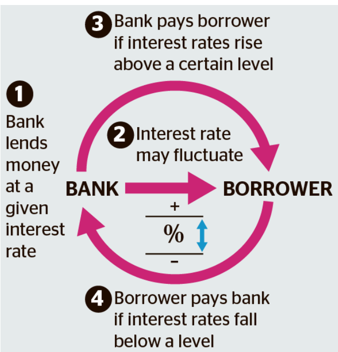
Published at 12:01AM, June 16 2014

In the days before the global financial crisis, thousands of small businesses sought help from their banks to fund expansion. In many cases, banks lent them money coupled with products providing protection against any rise in interest rates. One of the more complex forms of interest rate hedges was a "swap", whereby a bank would pay cash to a business if rates rose above a certain level, offsetting the extra interest a business would be repaying. However, if interest rates fell below a certain level, the deal would swing the other way.



Serious problems arose when the Bank of England slashed its base rate five years ago to a historic low of 0.5 per cent, where it has remained ever since. Small businesses ended up paying tens or even hundreds of thousands of pounds to the banks because interest rates went so far south.

In 2012, the Financial Conduct Authority ruled that banks should not have sold the swaps and other hedges to small businesses because they were too complicated and their risks had been poorly explained.

It ordered banks to put customers back in the position they would have been had they not been mis-sold. The banks were forced to bring in thousands of case workers to sift through millions of documents linked to claims.

Under the FCA scheme, banks can refund the cost of a swap, in full, if they decide that a customer would not have bought it. Equally, they can choose not to compensate the customer at all, because they are free to decide that the customer would have gone ahead and bought the swap anyway.

A third option for a bank is to decide that the customer would have bought an "alternative product" rather than the swap they were mis-sold. Under the FCA's rules, an alternative product has to be "simple". However, the banks are free to use an alternative swap to replace a mis-sold swap.

The banks are under no obligation to disclose their methodology or cal- culations if they offer substitute swaps or other alternative products to customers.

Compensation awards are checked by FCA-approved "independent reviewers", which are appointed by banks to review "all aspects" of their dealings with customers under the FCA scheme. These reviewers are the accountancy firms KPMG, Deloitte, EY and Grant Thornton; City law firms SJ Berwin, Macfarlanes and Berwin Leighton Paisner; and Promontory, the financial consultancy.

However, these calculations have been called into question. Abhishek Sachdev, managing director of Vedanta Hedging, a financial consultancy that advises MPs and small business owners on mis-sold hedges, said that some banks had over-valued substitute swaps. These erroneous valuations had passed through the independent reviewers and on to customers, who had been left out of pocket, he said.

Using historical pricing data from Reuters and Bloomberg, his firm has checked the valuations. On numerous occasions, the firm has found that a Reuters or Bloomberg price was far lower than the bank's price, Mr Sachdev said. The lower the price of a substitute swap, the more compensation a customer receives.

Mr Sachdev said that banks normally reduced their valuations of substitute swaps when they were challenged with the historical pricing data.

"Small businesses aren't really in a position to be able to price a derivative financial product like an interest rate swap," he said. "Nor is it helpful when their bank gives them no information at all about how they reached their pricing decision.

"One central principle of the FCA's scheme is that complex products are bad and simple ones are good. What's more important is the sales process. There's nothing wrong with a complex product if it's suitable. Demonising complex products and leaving the door open to substitute in simple products doesn't get to the heart of the issue."

Craig McAdam, a partner at law firm Slater & Gordon, advises companies on claiming compensation for mis-sold swaps.

He said the banks were making "nonsensical" decisions that were "unfair" for small businesses, especially those that could not afford to take legal action.

Small business owners who disagree with their bank's assessment of their redress claim are unable to complain to the Financial Ombudsman Service.

A spokesman for one of the high street banks said it was committed to ensuring fair and reasonable outcomes for all customers, which included the pricing of alternative products.

Hedge glossary

Swaps Generally regarded as the most complex form of hedge. The bank agrees to pay the customer money if interest rates rise, so that they can cover the cost of higher interest repayments on their loan. Conversely, the customer pays the bank fees if interest rates fall.

Caps These reduce the burden of increasing loan repayments if the base interest rate goes up. The bank pays the customer money to offset higher loan repayments if the base rate rises above a certain level. The customer pays an upfront fee or a regular premium for having the cap.

Simple collars These allow customers to limit interest rate fluctuations within a range. If rates rise above an agreed "ceiling", interest repayments on loans are capped. If rates fall below a certain "floor", repayments are also capped.

Structured collars Similar to simple collars but the "floor" element is more complex, and can lead to higher loan repayments.

Case study

Doug Wardle, a 79-year-old businessman from Staffordshire, is the owner of Wardle Property and former owner of Wardle Transport, a bus operator. He took out a business loan from RBS in 2006. The £2.2 million loan was to be secured against £3.1 million of property, but the bank said Mr Wardle had to buy three interest rate swaps as a condition of the loan.

Not long after he signed the deal, the financial crisis struck. This prompted a fall in the value of the property secured against his loan. The crisis also forced the Bank of England to slash its base rate to 0.5 per cent, which meant Mr Wardle was liable to pay RBS thousands of pounds a month in fees under the swaps arrangements.

Because of the fall in the value of his property, RBS became concerned about Mr Wardle's security for the loan. It asked him to repay £1 million to offset this. He was advised to sell property to cover the costs. However, he relied on this property to pay the bank's fees under the swaps contracts. The bank refused to cancel the swaps contracts unless Mr Wardle paid £220,000 in exit fees.

Mr Wardle sold Wardle Transport to Arriva in 2010 in order to reduce his loan to £1.25 million. On that £1.25 million, he was paying RBS £111,752 a year in interest and £71,780 a year in swaps fees — equivalent to an interest rate of 14.7 per cent. By the time he lodged three mis-selling claims under the FCA's scheme, he had paid £410,000 in swaps fees alone.

RBS responded to his first and smallest claim, for £1,100, in February. It admitted it had mis-sold the swap but said he was not due any compensation. In fact, RBS decided that Mr Wardle owed the bank £925 in fees.

It reached the conclusion that had Mr Wardle not been mis-sold the swap, he would have bought another type of swap anyway. In Mr Wardle's case, the bank decided that he would have bought a more expensive swap. The bank did not ask him to pay the additional £925 of fees.

Mr Wardle received a letter from RBS last month regarding his second and largest claim, for £260,000. As with the first, RBS decided that he would have bought another type of swap had he not been mis-sold the original swap. It concluded Mr Wardle would have paid £207,000 in fees for this alternative swap. It offered to refund him the difference — £53,000 — plus interest.

Mr Wardle is awaiting the bank's decision regarding his third claim, for £150,000.

Craig McAdam, partner at law firm Slater & Gordon, who is advising Mr Wardle on his claims, said that the bank had refused to reveal its methodology for calculating its compensation awards despite being asked to do so.

Karen Bradley, MP for Staffordshire Moorlands, said that Mr Wardle "needs to know the basis of the calculation they are using. And of course it needs to be a fair settlement."

Mr Wardle said: "I am 79 years old and the bank has effectively been controlling my life. I have been forced to sell a very profitable bus and coach business and also to sell property. No matter what the bank may offer now in the way of redress, I cannot go back in time."

A spokeswoman for RBS said: "RBS has worked in line with the FCA agreed process throughout to ensure all customers mis-sold these products get fair and reasonable redress. All final outcomes are reviewed and approved by the independent reviewer."