

LLOYDS BANK - INTEREST RATE HEDGING PRODUCT (IRHP) MIS-SELLING £4.6 MILLION GBP LITIGATION SETTLEMENT WITH SME CARE HOME

LONDON, UK - Lloyds Bank Plc (LLOY.L) has settled a High Court claim¹ over the mis-selling of three complex financial derivatives², sold initially in July 2007 and then restructured in December 2008³, to The Coin Group Limited, an SME that operates care homes in Buckinghamshire.

The 30-year restructured trade product sold in December 2008 was a *'heads I win, tails you lose'* derivatives product known as a callable (i.e. cancellable) swap. This meant that Lloyds retained an option to cancel and make potentially huge profit from the derivative if interest rates rose (which would be the very time that interest rate protection was needed). The bank could make such a profit by pocketing the break cost via the call option. However, if interest rates remained low and the customer wanted to cancel, the break cost would be prohibitively expensive for the customer. The customer only had a 4-year loan from Lloyds and yet the bank sold a 30-year derivative product, which mis-match left the customer massively over-hedged. In the circumstances, the derivative amounted to a one-sided gamble by the bank with the customer's assets.

Under this settlement, Lloyds has agreed (i) to pay £890,523.98 GBP in respect of all derivatives payments previously paid by the customer, (ii) to bear the break cost of the one extant hedging product estimated in the sum of around £3.5 million GBP, and (iii) to pay £200,000 GBP towards the care home's legal costs. The litigation settlement has cost Lloyds Bank Plc in the region of £4.6 million GBP, which amounts to almost the entire claim value, although the bank continues to deny any liability.

Usually such settlements contain confidentiality clauses and the details cannot be placed in the public domain. On this occasion however, the customer refused Lloyds' demands of confidentiality for two central reasons. Firstly, in order to demonstrate to the wider public the flaws and inadequacies of the Financial Conduct Authority (FCA) backed IRHP Review Scheme⁴, in which the major banks have been allowed to review their own past sales of derivatives (in spite of the FSA, as it then was, publishing⁵ a finding of mis-selling in 93% of IRHP sales examined in a pilot review scheme). Coin Group took part in that pilot review scheme but was never informed of the outcome and instead was ousted from the review scheme after the major banks somehow⁶ collectively persuaded the FCA to exclude higher

¹ The Coin Group Limited v. Lloyds TSB Bank PLC (High Court of Justice, Queen's Bench Division, London Mercantile Court, Claim No: 2013 Folio 944); proceedings were commenced on 15 July 2013.

² The derivatives were: (i) a £2.25m 14-year Callable Swap entered into on 24 July 2007; and (ii) a £2.25m 14-year Enhanced Collar entered into on 24 July 2007, amended on 14 January 2008; and (iii) a £6m 30-year Callable Swap entered into on 1 December 2008 and represented to CGL by Lloyds as a way of restructuring the first two IRHPs in order to alleviate the financial difficulties caused by them.

³ In July 2007, Lloyds sold a total of £4.5 million of hedging to the Coin Group for 14 years. When the Coin Group complained about the costs of that hedging, Lloyds recommended and sold a restructure in December 2008, which replacement hedging had an even bigger detriment as it had a value of £6 million for 30 years.

⁴ See LEXLAW letter to FCA dated 10 October 2013 titled [Notice of Failings in and Abuses of the IRHP Review](#).

⁵ [FCA Pilot Findings, 31 January 2013](#): "The work on the pilot has confirmed the FSA's initial findings that there was significant mis-selling of IRHPs. We looked at 173 sales to 'non-sophisticated' customers in the pilot and found that over 90% did not comply with one or more of our regulatory requirements."

⁶ Andrew Verity has reported on BBC Newsnight that Her Majesty's Treasury pressurised the FCA to water down the redress scheme to save billions of pounds of redress for the major banks, two of whom had been bailed out by the UK taxpayer (Lloyds and Royal Bank of Scotland); [Newsnight, 23 July 2015](#).

value claims⁷. Secondly, because Lloyds refused to put things right fully⁸ by not refunding overdraft fees and interest suffered by the care home by reason of the derivative mis-selling.

Mr Errol Bland, Director of the Coin Group, stated:

“The hedging payments forced us to go over our agreed overdraft facility limit, and Lloyds charged us unauthorised overdraft fees and interest of almost £130,000 on that unauthorised borrowing. However, Lloyds has refused to return that money, which would not have been charged had it not been for the callable swap that they mis-sold. This is an unfair and immoral decision by Lloyds, which exemplifies the way that we were treated by them throughout this dispute. No matter what Lloyds says about changing its profit-first culture, it continues to fail to put things right. Not only have we had to put our business growth plans on hold for the past five and a half years, but we have had to incur legal and professional costs to defend ourselves against something that was mis-sold to us but still ended up costing us over £130,000 in fees and interest. Since the start of this dispute, Lloyds has tried everything that it could to create hardship and financial instability for my business. Lloyds should be spending its resources on truly supporting businesses and rectifying the problems that it has caused its customers, rather than losing millions of pounds in break costs whilst trying to escape accountability for its mis-selling.”

Mr [M. Ali Akram](#), a partner and dual qualified barrister and solicitor practising at [LEXLAW Solicitors & Barristers](#), the City of London law firm that represented the care home stated:

“The Coin Group took part in the FSA pilot IRHP review scheme without any legal assistance, on the basis of its faith in the financial regulator, until it was ejected by Lloyds due to a change in the IRHP scheme to exclude so-called ‘sophisticated’⁹ customers. Notably, communication of that ejection decision was delayed by Lloyds for several months for no valid reason except perhaps the hope that the care home’s legal rights would become time barred. Indeed, the decision letter from Lloyds that labelled our client as ‘sophisticated’ finally arrived, seven or so months late, just weeks after our client’s primary legal rights had expired by virtue of the Limitation Act. Fortunately, having taken legal advice in time, an urgent protective claim form was issued and litigation commenced. The litigation was, as usual¹⁰, vigorously defended by Lloyds Bank and the heavyweight legal team they fielded to deny liability¹¹. Therefore, whilst Lloyds escaped compensating this customer millions of pounds in its FCA-backed (but remarkably self-administered) IRHP review scheme, the bank was forced to settle our client’s litigation claim in order to avoid judicial scrutiny and judgment over its past sales conduct. Lloyds Bank Plc has agreed to bear financial losses

⁷ Thousands of small business that have been excluded from the IRHP review scheme are contemplating legal action against the government for its failure to apply the Markets in Financial Instruments Directive (MiFID) rules correctly (see Kiki Loizou reporting for the Sunday Times on 25 January 2015: [‘Taxpayer may face £2bn bill over swaps mis-selling scandal’](#)).

⁸ In a recent interview with Jill Treanor published in the [Guardian](#) (28 March 2015), Lloyds’ CEO, António Horta-Osório, claimed he was “instilling a new culture, one where people must try to do the right thing” yet he has refused to credit unauthorised overdraft fees and interest charged because of the mis-selling and has ignored correspondence on the subject.

⁹ The FSA announced the ‘sophistication test’ on 31 January 2013. It appears from a report by Andy Verity for the BBC that the [‘Regulator capped mis-selling payments’](#) following lobbying by HM Treasury. The ‘sophistication test’ is not a test of sophistication but a prejudicially named set of criteria designed to save the banks an estimated £28 billion GBP of compensation truly owed to UK SMEs.

¹⁰ See James Cusick reporting for the Independent on 23 June 2014: [‘Exclusive: £22bn threat to banks in latest mis-selling ‘scandal’ that could rival PPI payouts’](#).

¹¹ Lloyds were represented by Norton Rose Fulbright partner Mr Paul Morris, senior associate Mr Dominic Hennessy, and associate Ms Saskia Price, in addition to Lloyds’ Head of Complaints Disputes & Litigation Programme, Mr Ed Massey.

which, on this one case alone, are likely to be in the region of £4.6 million however the bank has made no admission of liability. Within this figure lies the break cost of the restructured £6 million 30-year callable swap. If Lloyds had settled this claim around twelve months ago, the break cost of that swap would have been in the region of £1.8 million; instead the bank is likely to have incurred a recent break cost of up to £3.5 million¹². This highlights the massive contingent liabilities involved in these complex financial instruments, which liabilities were purposefully hidden from SMEs to allow the major banks, and their incentivised staff, to make huge profits on these derivatives trades."

Mr [Kumaran Sivathillainathan](#), a senior associate solicitor at city law firm [LEXLAW Solicitors & Barristers](#) which represented The Coin Group stated:

"A scandal that has not yet been remedied by any review scheme is that many major banks and building societies have routinely sold hidden swaps¹³ to customers by embedding such derivatives into fixed rate loans to avoid derivatives regulation. In this case, Lloyds Bank defended selling complex financial derivative products by alleging that the Coin Group already understood the risk of break costs because it had two structured collars from Yorkshire Bank¹⁴. Yorkshire Bank however describes these structured collars as 'fixed rate loans'. Lloyds also sells fixed rate loans but routinely denies these are derivatives, even though they are similar to the 'fixed rate loans' sold by Yorkshire Bank. Lloyds and other major banks portray derivatives as 'fixed rate loans' to avoid regulation that governs the sale of derivatives to customers. Yorkshire Bank has since accepted that the Coin Group did not understand the risk of break costs involved with these structured collars and has agreed to pay compensation. Lloyds' hypocrisy in attempting to use Yorkshire Bank's mis-selling to defend and justify its own poor sales conduct was therefore unsuccessful. This demonstrates the weakness in regulatory scrutiny of banks which the FCA themselves complained to the Treasury about in November 2013¹⁵."

The Coin Group's derivatives expert, Mr [Abhishek Sachdev](#), of FCA-authorized financial risk management consultancy [Vedanta Hedging](#) stated:

"The derivatives sold to this care home were highly complex and one-sided. Whether interest rates rose, or fell, the callable swap was 'hard-wired' to work against the best interests of the Coin Group. Furthermore, Lloyds restructured already complex derivatives¹⁶ into even longer-term structures, for no apparent risk management reason. Mr Bland was not told that, even at the time of this restructure in 2008, breakage costs for the existing derivatives were already around £800,000 before the much larger 30-year callable swap was sold. The callable swap did not provide long-term protection and was a speculative derivative rather than a hedging transaction. Lloyds also significantly over-hedged the customer in terms of

¹² In June 2014, the breakage cost of the hedging was £1.8 million. By February 2015, the breakage cost had increased to £3.5 million.

¹³ For more information on hidden swaps mis-selling see campaign group [Bully-Banks' Hidden Swaps Factsheet](#) and [Frequently Asked Questions](#).

¹⁴ See paragraphs 6(1), 9(3) and 43(3)(a) of the Defence in *The Coin Group Limited v. Lloyds TSB Bank PLC* (High Court of Justice, Queen's Bench Division, London Mercantile Court, Claim No: 2013 Folio 944)

¹⁵ Martin Wheatley, Chief Executive of the Financial Conduct Authority: *"We have concerns that firms ... may consider 'embedding' all their IRHPs into commercial loans in future and thus avoid our regulatory oversight altogether. This could include 'embedding' some of the most complex IRHPs (e.g. Structured Collars), which the banks have agreed to stop marketing to retail customers"* (see [12 November 2013 Letter from FCA's Martin Wheatley to HM Treasury](#) and Harry Wilson reporting for the Telegraph on 19 December 2013: ['FCA chief warns Treasury swaps scandal could be 'significantly' bigger'](#)).

¹⁶ Including a highly complex 'Category A' Enhanced Collar; the major banks have since agreed with the FCA not to market such structured collars to SME customers (see ['FSA agrees settlement with four banks over interest rate hedging products'](#))

amount and duration because, at the time of the 30-year callable swap commitment, the Bank had only committed to provide debt for circa 4 years. Lloyds also failed to disclose the material contingent liabilities which were circa £2.5 million at the time of entering into the 30-year callable swap. This contingent liability had a negative impact on the credit worthiness of the Coin Group (similar to an extra loan or overdraft) but this was never explained to the client. Lloyds generated over £400,000 in upfront trading income from the sale of all of the derivatives to the Coin Group."

Notes for editors:

- i. Lloyds sold complex callable swaps ('heads I win, tails you lose') that were speculative 'gambling' to benefit the bank rather than hedging to benefit the customer.
- ii. Lloyds failed to disclose the break costs of £800,000 from the first two derivatives to the customer before selling the third derivative.
- iii. Lloyds failed to disclose the contingent liabilities (estimated break costs) of £2.5 million before selling third derivative to customer.
- iv. Lloyds massively over-hedged the customer (30-year callable swap vs. 4-year loan).
- v. Lloyds profited £400,000 by mis-selling three complex derivatives to SME care home.
- vi. Litigation settlement cost Lloyds in the region of £4.6 million; break cost almost doubled (from £1.8 million to £3.5 million) in six months due to Lloyds' denials.
- vii. FCA allows banks to review their own past sales of derivatives and decide level of redress to pay; Lloyds likely to have decided in IRHP review scheme that there was wrongdoing in past conduct but decided in any event to pay nothing.
- viii. The IRHP review scheme is similar to a trial where the defendant is also the judge.
- ix. Lloyds ejected customer from IRHP review but failed to inform SME for 7 months (until after limitation date passed and SME's legal rights would then be time barred).
- x. Lloyds charged (and refuses to refund) almost £130,000 in overdraft fees and interest to customer which were suffered due to the mis-sold derivative.
- xi. Lloyds relied on Yorkshire Bank's sales mistakes to justify its own mis-selling. Following this logic through from the defence, Lloyds' own 'fixed rate loans' containing swaps can be considered to be regulated embedded derivatives.

Contact details for editors:

- i. **Vedanta Hedging** is the largest FCA-regulated hedging advisory organisation in the UK for SMEs and has advised hundreds of clients in connection with the mis-selling of derivatives in both the FCA-backed IRHP review scheme and in litigation by providing expert witnesses. The Managing Director, Mr Abhishek Sachdev, can be contacted by email on abhishek@vedantahedging.com or telephone on 020 7183 2277.
- ii. **LEXLAW Solicitors & Barristers** is a unique law firm that partners solicitors and barristers and is the only law firm based in the Middle Temple (an Inn of Court). The firm has conducted more litigation in respect of derivatives mis-selling to SMEs than any other law firm in the UK. The partner in this case, Mr M. Ali Akram, can be contacted by email on maa@lexlaw.co.uk or telephone on 020 7183 0529.
- iii. **The Coin Group** is an SME operator of care homes and investment property in the Buckinghamshire area, established since 1998. The owner and Managing Director, Mr. Errol Bland, was featured in a news report by Laura Kuenssberg for ITV News titled '[Businesses worried about delays in resolving 'swaps' dispute](#)' discussing delays in the IRHP review scheme. Mr Bland can be contacted for further comment by email on errol@coin-uk.co.uk or via his legal representatives.

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