<u>Consequential Loss Claims – Marching to the Beat of the Bank's Drum</u>

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In recent articles we have written about the progress of the FCA's IRHP review process, and the relatively poor take up of the redress offered – approximately 36% of those offered basic redress thus far have decided to take it. However, even this figure requires further examination, as with some banks the offer is 'fill or kill' in other words, take it or put in a full claim for consequential losses, but risk losing the initial offer. Other banks are offering basic redress with separate and further consideration of consequential losses which are treated separately. These different approaches mean that we don't know if the 36% who have accepted basic redress have put in, or are considering a further claim for consequential losses or not.

To add to the confusion and uncertainty we have differing judicial views on the nature and standing of the 'redress letters'. On the one hand we have information to suggest that certain claimants within litigation have obtained judgment on the basis that the redress letter is an admission of liability. On the other we have been in court when the judge has stated categorically that the redress letter is not an admission of liability but simply an 'offer to settle'. Finally, we have confirmation from a defendant bank that the redress letter is an admission of liability for the purposes of the 'case in hand'.

One thing we can be certain about is that the reserves that the banks have put aside for likely costs arising out of claims of mis-selling of interest rate hedging products include likely claims for consequential losses. At the current pay-out rate of a little under £150,000 a case, the likely clean-up bill for the banks is going to be less than the cost of setting up the review process, so we know its within their sights that they will inevitably pay some consequential losses to some claimants.

Basic redress includes in most cases direct payments that were historically made under the IRHP, a tear-up of the contract and therefore no future payments, and 8% added to the payments made. The banks will glibly tell us that the 8% covers any additional costs that the claimant might have suffered, for example from having to borrow money from other sources, for the opportunity cost of not having that cash to spend. In this we feel they are wrong.
I looked up 'statutory interest' this morning. The Financial Ombudsman Service has a useful definition of its intention;

'Compensation for being "deprived" of money and for investment loss'

The word 'statutory' though gives us a further clue. Statutory is derived from 'statute' a law relating to the statutory 'right' to interest.To clarify this, the 8% that the banks are 'offering' is in fact duty bound; its not a kind gesture intended as a catch-all to take care of and sweep away and additional costs that the claimant has suffered as an consequence of the IRHP.

So, what can and does a consequential loss potentially include and comprise? Is it worth the aggravation of claiming it, and will it 'harm' the original offer of basic redress where offered? All good and valid questions and in the picture below we have tried to demonstrate a pyramid of consequential loss claims.

We feel strongly that the banks need to address, encompass and include provable other direct costs that relate to the IRHP. These include items like overdraft charges that were levied by the bank as a result of perhaps exceeding an overdraft limit due to a payment made or taken under a swap. They also include any arrangement fees that the bank charged for renegotiating a loan that otherwise would not have happened or would not have been needed, were it not for the swap. Most SMEs will have records of these types of charges and costs within their bank statements. Furthermore, direct costs include the costs of appointing legal and other professional advisors and experts.

Less easy to define, but equally damaging are other related costs, such as the increased margin charged on renegotiated loans, or costs of other finance that was taken in order to try to maintain payments under the swap. The banks are not volunteering to consider these, but we feel they should do .

Moving up the pyramid of claims, we then have costs which arguably are less easy to quantify and prove, but which where they exist are likely larger than direct costs; these can include foregone investment, deterioration of service that led to lost contracts or revenue, the sale of assets at 'fire-sale' prices, done in an attempt to make payments under the loan and hedge, rather than fall behind.

As we pointed out a few weeks back, these are all potentially valid claims, and they make the calculation of the true cost of the IRHP claim complicated, deep, and complex. We are happy that the head of the British Bankers Association, Mr Anthony Browne agrees with us on this point. He went on the ITN News to stress this.

So, whilst the banks and the FCA want the mis-selling of IRHP to be done and dusted by the end of May 2014 firstly it is unlikely, but secondly it is unwarranted. The redress offer letters are very neatly telling claimants that they have to fill or kill, or they have to submit consequential loss claims within a tight time frame, but do we really have to march to the banks' drum once again?

Is it not these tactics of tight timeframes, take it or leave it attitudes, 'we call the shots' and 'if you don't like it be damned' attitudes that led to all of this mis-selling in the first place?

This to us points to a sad continuation of the current UK high street banking malaise of not treating customers fairly. The offer of basic redress with further examination of consequential losses made difficult, thorny, and unnecessarily burdensome leads us to think that the banks are missing a trick. The reason behind why the banks are not embracing legitimate claims of consequential losses points to one thing and one thing only – they don't want to spend the cash and they would still rather incur the wrath and dissatisfaction of a loyal client base. Yet, this cash in many cases belongs to the SME; it was either taken by the bank or spent by their client in an effort to protect themselves against the actions of the banks themselves.

The reasons why the banks don't want to part with this cash, is because firstly it is potentially large, and secondly it further depletes the profitability of the banks, and their ability to put

retained earnings into capital.

Banks globally over the next ten years face significant challenges. Post the financial crisis banks are in worse shape, and forward looking regulatory reforms determine that in future banks must be less likely to fail and less likely to rely on governmental support. A large part of these reforms mean that banks have to both hold more capital against any future losses, and hold better quality capital (Tier 1 and what we might call 'going concern' capital). The risks attributed to lending, dealing in stocks and shares, holding bonds, trading derivatives will all increase and change, meaning that those banks with a weaker capital base will have to draw back on banking activity. This will lead to a pressure on profitability, which leads potentially to a weaker capital position, lower investment and so on.

But there is another side of this coin that the banks ought to be thinking about right now. Firstly, the new FCA has embodied one very important aspect within its 'Approved Persons Regime' that is 'Treating Customers Fairly' which will over the next few months and years become not just a nice to have, but an enforceable rule that applies to all employees, not just a focus on the top few tiers of management. Secondly, banks have to improve not just the quality of their assets, but the quantity and quality of their liabilities, and that dear SME owner means your deposits. Yes, banks need to collect in increasing numbers what are called 'sticky deposits' that is, deposits that will be lodged with the banks for longer, and which will be less sensitive to short term banking problems (i.e. customers won't move them at the drop of a hat if they smell trouble or fall out with their bank). So, in short, banks need to woo clients with money, and as the economy draws its way out of recession and more positive times return, SMEs and large enterprises will once again be a rich source of cash.

So, the UK's high street banks can't afford to be short sighted, especially at a time when other European and global banks that were less affected by the financial crisis are in a stronger position to offer loans and other banking services, and are not tarred with the same mis-selling brush.

The CEOs of the UK's big four banks need to do more than forego this year's bonuses; they need to take a good look at what practicing what they preach really entails and for once to get it right and get this sorry tale behind us.

Best Regards
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