Tailored Business Loans – Fighting them at their own game?

In his testimony to the Treasury Committee, Clydesdale's CEO Mr Thorburn came within a whisker of offering to add the fixed rate tailored business loans into its review process alongside the review that it is currently conducting into the specific types of TBLs called either a Modified Participating Fixed Rate Loan Facility or a Discounted Fixed Rate Range Facility. These are in the review firstly because they are embedded derivatives, and secondly because Clydesdale wants to throw a bone to the Financial Conduct Authority; if it includes these two types it believes it can get away with excluding fixed rate loans.

A word about embeddedness. According to accountancy principles, the definition of an embedded derivative is that if the derivative contract is disembedded, and made 'stand-alone' if it continued to act and produce a stream of payments (under a contract for difference procedure) then it was previously an embedded derivative. This is important for two reasons; firstly because it then arguably comes under MiFID (and COBS) and secondly because it proves, by elimination, that a fixed rate tailored business loan has no embedded swap.

Clydesdale Bank has concluded that fixed rate TBLs are to be kept out of its own review, however, Mr Thorburn and Ms Crosbie both confirmed that if borrowers had cause to complain about fixed rate loans, they would look at them on an individual basis. For those who have launched their own compliants, and been constantly and consistently rebuffed however, this is cold comfort. On Friday I tried myself to speak to the customer engagement team at Clydesdale, in order to ask a question about the first date of the structured tailored business loans that it will count as including in the review (answer was 31/1/01), and it took me until Monday to get a response. Most that I spoke to on the helpdesk proved no help at all; the vast majority (and I spoke to around a dozen) professed to have no knowledge of TBLs at all.

Other banks that sold fixed rate TBLs with this particular sting in the tail (huge break costs) have had their fingers firmly crossed for a couple of years, and each time they think it's safe to uncross them, someone challenges them again. Whilst Clydesale and Yorkshire Bank sold approximately 10,000 tailored business loans, other banks sold fixed rate loans where the break cost is calculated on the same basis, that is the mark to market value of a residual interest rate swap. Nationwide Building Society, Lloyds Bank, and other (now) subsidiaries like Halifax and Bank of Scotland also made fixed rate loans on the same basis.

Inclusion in the redress exercise would not likely prove much of a fillip in any case, as we have seen from the main FCA Interest Rate Hedging Product Review. Here, what started in the main as a series of basic redress offers has deteriorated into a shambolic money saving exercise, with 'computer says no' type of offers going out towards the end. It would be naïve to expect more from the Clydesdale if they were either forced to, or volunteed to conduct a full review of their fixed rate loan TBLs.

What hope at the Financial Ombudsman Service? Recently, FoS has up-held decisions in favour of the borrower, and it has even over-turned previous negative decisions. Its decision making criteria though seems to revolve solely around an analysis of whether the bank provided a thorough and proper explanation of break costs up-front and herein lies the rub. The bank says it did, and the borrower says it didn't and therefore the decision that FoS makes swings on the individual case, and the view of the FoS adjudicator. Some adjudicators appear to be more switched on that others in their understanding of TBLs, and it is a lottery which one picks up a case.

Much more clinical for me is to match the bank at its own game. The bank produces a calculation based upon the cost that it would incur if it had itself bought a stand-alone interest rate swap to hedge the floating rate loan that it lend out. We know that the bank didn't enter into micro-hedging of loans but that it used macro-hedging techniques. Whilst from the outset the methodology it uses is therefore flawed, the banks say it is a proxy calculation that does represent its costs. The evidence from the accounts runs contrary to this, and a combination of annual reports from 2008 to 2012 for Clydesdale, and from 2008 to 2010 for the parent bank National Australia Bank conflicts with the costs that the bank provides as its 'break costs'. The reality is very different. A large part of why the bank has been so keen to keep these tailored business loans out of the review is because it doesn't want questioned its hedge accounting methodology and face any subsequent ineffectiveness that hits its captial line.

This clinical approach is likely to halt Mr Thorburn is his tracks and it will likely provide a great deal of discomfort to FoS. The same goes at Triodos UK, and whilst our studies have not yet extended to the Lloyds Group or Barclays, we feel confident in our approach.

Best Regards
Simon Jaquiss

www.qalegal.co.uk

01794 341040

07415485849