

## Interest Rate Hedging Disputes

### The issues

The sale of interest rate hedging products ("IRHPs") such as caps, collars, structured collars and interest rate swaps has attracted a considerable amount of press coverage over the last 12 months. Over the last decade, these products have been heavily promoted by the major banks as a way of protecting businesses against fluctuations in interest rates and limiting their exposure to sharp increases in interest rates which might have caused their borrowing costs to become unaffordable. But last summer, after coming across many cases of bad practice by a number of retail banks in selling these products to businesses, particularly SMEs, the FSA (which has been replaced by the FCA and the PRA) announced that the banks had agreed to review the sales of these products made after 1 December 2001 and to provide redress where appropriate.

This announcement came on the back of growing dissatisfaction and unrest amongst businesses about the way they had been treated by the banks, with many having already commenced legal action against the banks to recover their losses. Some of the common complaints include:

- banks failing to properly explain how these products work;
- banks failing to check whether the customer understood how the product worked / or the explanation provided;
- banks failing to explain what would happen if interest rates fell, focussing instead only on what would happen if rates rose;
- banks failing to disclose or highlight the substantial exit costs that would be applicable to some products;

- banks selling products which exceeded the length of the customer's borrowing, known as overhedging;
- banks selling products linked to LIBOR when the customer's borrowing was linked to base rates;
- banks leading the customer to believe that it would be able to exit the agreement after a set period of time, only for the customer to discover that only the bank had this option;
- banks requiring customers to take out an IRHP as a pre-condition of any loan;
- banks telling customers that taking out an IRHP was a pre-condition of any loan when it was not.

In January 2013, the FSA announced that based on a pilot study, the major banks had failed to follow one or more regulatory requirements in over 90% of cases and that the banks would now proceed to review their sales of IRHPs on the basis of the principles set out in its report. Then, in February 2013, it announced the results of the pilot study for other high street banks and confirmed that these banks would also be reviewing their sales of IRHPs in accordance with the same principles.

The finding that over 90% of IRHPs may have been mis-sold may confirm what many SMEs have probably suspected for a long time already. But whilst the announcement of a wholesale review is welcome news, especially for those SMEs which are now struggling financially after interest rates plummeted in early 2009 or which have had to pay a hefty redemption penalty in order to extricate themselves from their IRHP, the

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review process applies only to customers who meet specific criteria.

Customers deemed to be “sophisticated”, i.e. who at the time of the sale had a turnover of more than £6.5 million and either or both of: a balance sheet total of more than £3.26 million; and/or more than 50 employees are excluded. Customers who meet the balance sheet and employee number criteria only are included in the review only if the total value of their IRHPs is equal to or less than £10million.

Additionally, if a bank considers that a customer had the necessary knowledge and experience to understand the type of product that was being sold, it may also argue that the customer’s case falls outside the parameters of the review scheme, even if that business does not meet the defined criteria of a sophisticated customer. If this happens, a borrower may still end up facing a battle to obtain redress from its lender.

Even if customers can expect the sale of their own IRHPs to be reviewed, there is no guarantee that they will receive the redress they are entitled to. They will still need to put forward persuasive evidence that their IRHP was mis-sold as part of the review process and demonstrate that their bank was providing them with advice or misleading information. Disagreements may also arise as to what the customer would have done if its bank had complied with its regulatory requirements. If a customer disagrees with the outcome of the review and considers the redress offered to be insufficient or unreasonable, it will then need to pursue a claim through the courts.

Customers who are approaching the sixth anniversary of the sale of their IRHP should take particular care. The recent decision of the Court of Appeal in *Green and Rowley v. Royal Bank of Scotland* illustrates that it is

crucial to commence a court claim within this six year period; at the moment, it is not possible to argue that the banks owed a common law duty of care to comply with their regulatory obligations, which might have extended the 6-year deadline in some cases. If they wait for their case to be reviewed and are dissatisfied with its outcome, they may face difficulty in seeking redress through the courts instead because the limitation period, i.e. the deadline by which they must commence a court claim, may by then have expired. This may potentially give their bank a technical defence to any court claim and could leave them with no option but to accept whatever compensation is offered to them.

### What do we offer?

Thomson Snell & Passmore is already acting for borrowers who are seeking redress from their lender. We are happy to look into the merits of any claim and to attend an initial meeting to discuss a prospective client’s individual circumstances, establish their objectives and offer a preliminary view on the merits of their position.

Borrowers who fall within the scope of the review may feel that they need some assistance with making submissions and representations to their bank during the review process. We can provide assistance with this process on a private fee paying basis, though if we consider that the merits of a case are strong, we may consider agreeing to defer the payment of our fees until the conclusion of the review process. Alternatively, if we consider that the merits of any claim are sufficiently strong, we can consider offering a no “win, no fee” CFA so that a business would only have to pay any fees (plus a success fee) if it was awarded redress.

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For those borrowers who fall outside the scope of the review altogether, or who remain dissatisfied with a bank's offer of redress and want to continue to pursue their claim through the courts, where we consider that the merits of any claim are sufficiently strong, we will offer to act under a "no win, no fee" CFA and we will include our costs of any initial meeting in the costs claim we put to your opponent if we succeed. This will enable businesses to obtain legal advice and to pursue a claim without having to bear the financial risk of the claim not succeeding.

If we do not consider that the merits of a case are so strong, we will discuss other funding options such as a "no win, discounted fee" CFA or a staged approach on a private fee paying basis where we agree the relevant steps and provide fixed fees or estimates for those steps so that our clients have as much certainty about their likely fees as possible.

Our entire approach to the resolution of disputes is to identify solutions which meet our clients' objectives and which are realistic and commercial. In the context of interest rate hedging product claims, this may involve negotiating with a lender to secure a borrower's release from its existing interest rate hedging instrument on significantly more favourable terms than the lender is proposing. It may also include negotiating financial redress where the hedging instrument has exposed the borrower to a higher degree of risk and, therefore, a higher financial burden, than the borrower would have chosen if the product and the risks associated with it had been properly explained at the time it was taken out. At each stage we will weigh up the potential benefits to be gained from proceeding further as compared to negotiating a settlement on the terms then available, bearing in mind the likely costs

and other risks associated with proceeding further. We will at all times seek to minimise the risk that a client faces.

We also have links with experts in the banking industry who can offer a valuable and bespoke insight into a customer's particular circumstances, including a preliminary view on the redress that a customer is entitled to and the quantum of their claim. This expertise will be particularly beneficial for those customers who may be uncertain whether to accept any redress that they may be offered.

For further information, please contact James Ward, Kamal Aggarwal or Nick Horton as below:

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