DRN-4309252

The complaint

A company, which I'll refer to as T, complains that it was mis-sold a fixed rate commercial loan by Lloyds Bank PLC. T also complains that the security which the bank required caused problems for the company.

What happened

In April 2014, T took out two loans from Lloyds – a 20-year loan for £385,700 with the interest rate fixed for the first ten years, and a 15-year loan for £172,500 with a variable rate.

In November 2018, when T repaid the fixed-rate loan in full, the company was required to pay a break cost of over £27,000 for ending the fixed rate contract early.

T complained to the bank, saying that its director was over 55 when the loan was sold, so it was unreasonable for Lloyds to provide a long loan term without an option to break without penalty. Moreover, T said the bank didn't mention the break costs within the facility term letters and the director wasn't advised about the break costs in any of the meetings with Lloyds' staff.

T also complained that the fixed-rate loan was secured over two properties, which prevented the company from releasing equity, remortgaging, or selling the properties without redeeming both of its loans.

Lloyds offered to pay compensation to take into account that the break cost actually incurred was higher than the example break cost shown at the point of sale. In August 2021, Lloyds calculated this offer to be £6,816.52 plus compensatory interest.

T wasn't happy with Lloyds' offer and referred its complaint to us. Having looked at the evidence, our investigator recommended that Lloyds should put T in the position it would have been if it had chosen a 20-year loan with the interest rate fixed for seven years, rather than ten. He gave these reasons, in summary:

- T's fixed rate loan wasn't a regulated mortgage contract, nor was it any other kind of regulated product. It was a commercial loan, so the rules for regulated mortgage contracts don't apply here. The investigator couldn't see any evidence that Lloyds recommended or required T to take a fixed-rate loan.

- The loan agreement clearly stated there would be 120 monthly instalments during the fixed rate period. The investigator therefore believed Lloyds gave T's director sufficient information to calculate at which age he would be when the fixed rate period would end.

- In 2014 T's director signed a loan agreement and a product profile, both of which explained that early termination of the fixed rate would result in a break cost.

- Although the investigator thought Lloyds clearly said there would be a break cost if the fixed rate were repaid early, he noted that the examples provided by the bank were based on a £100,000 loan fixed for five years, whereas T's actual loan was for £385,700 fixed for ten years. This led to a substantial difference between the highest example break cost of £6,000 and the actual £27,086 break cost paid by T. So the investigator didn't think Lloyds gave clear information about the potential size of the break cost.

- The investigator considered what T would have done if sufficient information had been provided at the time. He thought fixing the interest rate would have seemed attractive, as this would have given security from the risk of rates increasing in the future. He hadn't seen evidence to show that T intended to pay off the borrowing early, so he didn't think the risk of early exit costs would have outweighed the advantages of known, stable repayments for a substantial part of the loan term.

- Having said that, the investigator wasn't convinced that T would have fixed for ten years. Given T's intention to redevelop properties, it's likely that T would have regarded ten years as too long to be locked in by the potential break costs. Also taking into account that T's director said his planned retirement age was 65, the investigator thought it likely that T would have chosen to fix for seven years.

- Lloyds sent a letter in November 2013, which set out the security requirements for the lending proposal, naming the two properties. The investigator thought Lloyds had clearly said which properties were required to be used as security.

- T's representative argued that the bank should reimburse the company for the arrangement fee, introduction fee and other costs that T incurred in moving to a new lender in 2018. The investigator said that it had been T's decision to move, and it hadn't been required by Lloyds. There are typically such costs when taking out new lending with a bank, and the investigator didn't think it would be fair to ask Lloyds to pay these.

- T's representative had also asked for the bank to reimburse the company for its legal costs for bringing the complaint. The investigator said the ombudsman service doesn't require a complainant to appoint a solicitor to bring a complaint, and he therefore didn't think it would be fair to ask Lloyds to pay the legal fees.

Lloyds said that while it didn't agree with the investigator's assessment, it was prepared to make an offer in line with investigator's recommendations – in which the compensation would be higher than in the bank's original offer – in order to settle the complaint.

T didn't agree with the investigator's recommendations. Its representative said that T should be put in the position it would have been in if it hadn't taken a fixed rate of any duration. The representative made these points, in summary:

- The key need for T was flexibility over when it could repay, and this would always have outweighed the security of fixed repayment amounts over the longer period. Had T been offered the choice of appropriate products, specifically variable rate products across all of its borrowing, it would have chosen them as opposed to fixed rate lending.

- T was sold a fixed rate product alongside a variable rate product. This makes no sense and was the worst of all situations, keeping the customer tied in with early repayment charges but with uncertainty over the repayment amounts linked to rate changes. The bank should have provided proper advice.

- There would have been no seven-year fixed rate loans on offer by the bank at the time, so T could not have had such a product.

- Given the lengthy and detailed correspondence between T and the ombudsman, especially over jurisdiction, it's unfair to say that lay customers could navigate the situation without legal advisers.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

Having done that, I've reached the same conclusions as the investigator, and for largely the same reasons.

The fixed rate loan

Fixed rate commercial loans aren't regulated products, and they aren't subject to advice and suitability rules. I've seen no evidence that Lloyds provided advice or recommendations at the time of the loan sale. The loan agreement contained a statement by which the customer acknowledged that he hadn't received or relied on any advice from the bank. This statement was just above the customer signature. I'm therefore satisfied that the sale of the loan wasn't subject to the rules for regulated advice. That means the bank wasn't required to provide advice, and nor was it required to ensure that the product sold was suitable for the customer's needs – or even to make an assessment of those needs. It was up to the company to decide whether the fixed rate loan offered by the bank met its requirements and fitted with its business model.

Having said that, I would expect the bank to have provided the company with appropriate information to make an informed decision. In particular, I would expect the bank to alert the company to the risk of incurring break costs, and of the potential scale of those costs. Having looked at the sales information and the loan agreement, I find that Lloyds did give T sufficient information for the company to understand the basic operation of fixed rate lending as opposed to variable rate lending, including clear warnings about the possibility of break costs. But I agree with the investigator that Lloyds didn't give enough information about the potential scale of the break costs, because the range of the examples it gave was too narrow.

I'm satisfied that T chose a fixed rate knowing that the interest payments were more expensive than for a variable rate loan at the time, and knowing that exiting the fixed rate early could result in a break cost. T therefore chose the fixed rate product despite having to pay a premium at least in the short term, and despite some risk of a potential future break cost. I'm therefore satisfied that T chose the fixed rate because it was prepared to accept these actual and potential costs in return for its benefits – which were the predictability and stability of repayment outgoings over the fixed rate period. I therefore agree with the investigator that the evidence suggests that T valued the benefit of a fixed rate loan in giving security against the risk of future interest rate rises.

T wasn't fully informed about the potential scale of break costs. So I must consider what T would have done if the bank had given that information.

I think the company would have seen value in fixing its rate for as long as reasonably possible, but would have weighed that against the risk of incurring costs from early exit. It's not possible to determine exactly what would have happened if T had been fully informed, so I need to decide what I think was most likely.

I haven't seen any evidence from the time of the lending that T expressed any intention to repay early, so I think it's unlikely that T saw flexibility as its key need at the time, and I therefore believe T would have fixed for more than five years. In coming to that view, I've taken into account the general tendency of break costs to diminish towards the end of the fixed rate period. However, I think T would have seen ten years as too long, especially as its director was intending to retire before then. I think it's reasonable to conclude that seven years would be the limit of T's risk appetite. A fixed rate of that length would have come to an end more than a year before the director was 65, giving time for the company to plan and act before his retirement.

T's representative says that a seven-year fix wouldn't have been available, and that Lloyds would only have offered standard fixed terms of three, five and ten years. But my understanding is that it wasn't uncommon for banks to arrange fixed rate loans of different durations, depending on customer requirements. I believe that in 2014, T could have negotiated a fixed rate for seven years.

I don't agree with T's representative that the bank should have advised T against a mix of fixed and variable rates. It's not unusual for business borrowers to choose a combination like this, in order to give some control over future outgoings while preserving a degree of flexibility for early repayments. But in any event, these were unregulated loans and Lloyds was under no obligation to make recommendations or advise T about the suitability of products.

For the reasons given above, I find that a fair and reasonable outcome of the complaint would be for Lloyds to put T in the position it would have been in had the company had fixed its interest rate for seven years rather than ten years.

Security

I'm satisfied that Lloyds made its security requirements clear in advance of the 2014 lending. T accepted the loans with the security requirements. I don't think the bank acted unfairly or unreasonably here.

Costs of moving to another lender

T made a choice to refinance with another lender, and it wasn't required to do so by Lloyds. I agree with the investigator that it wouldn't be fair or reasonable to require Lloyds to pay for the routine fees and costs involved in obtaining new finance.

Legal fees for bringing the complaint

T has been represented by a solicitor, but that was the company's choice. It's not necessary to be represented in order to bring a complaint to the ombudsman, and it's very unusual for complainants to be awarded their representative's fees. I can see there were exchanges about T's eligibility as a complainant, and the company was asked to provide financial and staffing information. I've no doubt that having that correspondence handled by a solicitor made things easier for T's director, but I don't think professional representation was essential. So I don't think it would be reasonable to require the bank to reimburse T's legal costs.

My final decision

My final decision is that I require Lloyds Bank PLC to put T in the position it would have been in had it chosen a 20-year loan with the interest rate fixed for seven years, rather than the original 20-year loan with the interest rate fixed for ten years.

The award should reflect the following considerations:

- The replacement loan should run from the original start date.
- The bank should reimburse the difference between the break costs paid on the original loan and the break costs due on the replacement loan.
- The bank should reimburse the difference between the payments made on the original loan and those due on the replacement loan.
- The bank should add compensatory interest at 8% simple per annum to the reimbursed sums above, from the date the costs arose to the date of settlement.

Under the rules of the Financial Ombudsman Service, I’m required to ask T to accept or reject my decision before 17 January 2024.

Colin Brown
Ombudsman