

5. The Risk of the "Hidden Credit Line"

This is one of the most pernicious aspects of these arrangements.

- **How it Arises:** As interest rates fell post-2008, the swap went "out of the money" for the customer. This means its market value became negative. This negative value, known as the **Mark-to-Market (MtM) liability**, represents the net present value of all the future losses the bank expects the customer to incur over the life of the swap.
- **The Hidden Credit Line:** This MtM liability is, in effect, a **loan from the bank to the customer**. It is a credit exposure for the bank because if the customer defaults, the bank loses that value. However, this "loan" was never disclosed, discussed, or underwritten.
- **Risks to the Customer:**
 1. **Crippling Breakage Costs:** The MtM liability *is* the breakage cost. To exit the swap, the customer had to pay this entire amount to the bank in one lump sum. These costs often ran into hundreds of thousands of pounds, making it impossible for the business to refinance or escape the product. They were effectively trapped.
 2. **No Underwriting or Disclosure:** The customer was never told that by signing the document, they were also implicitly being granted a massive, undeclared credit line that would activate the moment interest rates fell. The bank never assessed the customer's ability to ever repay this potential liability.
 3. **Breach of Covenants:** The existence of this large, off-balance-sheet liability could put the customer in breach of financial covenants on their other loans (e.g., gearing or debt-service-coverage ratios), potentially triggering a default on their entire banking relationship. This gave the bank enormous leverage over the customer.

In conclusion, the documentation reveals a product that was likely misrepresented (sold as a cap), documented with profound contractual weaknesses that fall far short of industry standards, and structured in a way that created a hidden, undisclosed, and crippling financial liability for the bank's customer.

¹ Taken from a post on X on 9/1/2025 by @MlorrM

