

The complaint

Mr and Mrs R are unhappy that the terms of their equity release mortgage held with Legal & General Home Finance Limited (“L&G”) do not allow them to pay off the interest on the loan. They are also unhappy that the account is not split into two separate accounts – one for capital and one for interest – so these can be cleared separately.

To settle the complaint Mr and Mrs R would like L&G to allow them to pay off the interest, rather than this rolling up into the outstanding balance.

The complaint has been dealt with throughout by Mr R.

What happened

In August 2018, after taking advice from their own independent financial adviser and solicitor, Mr and Mrs R (then aged 65 and 61) took out an equity release mortgage with L&G. They borrowed £500,000, plus an arrangement fee of £599, at a fixed interest rate of 5.33%, secured by a mortgage against their property valued at £1.6 million.

In common with this type of mortgage, no monthly repayments are required; instead interest rolls up into the outstanding balance, which is repayable when the last surviving borrower dies. The mortgage offer contains a table showing how the roll-up of interest will increase the debt over a period of 24 years.

If the mortgage is repaid early – either in total or partially – an early repayment charge (ERC) will apply. Clause 13 of the mortgage offer explains the circumstances in which an ERC will be charged.

Clause 14 of the mortgage offer explains that in any 12-month period (starting on the completion date and on each anniversary thereafter) Optional Partial Repayments (“OPRs”) of up to 10% of the amount borrowed can be repaid, in up to four instalments of at least £500. L&G explains “*We do not include any interest accrued...*”.

Clause 14 also says: “*Partial repayments in excess of the [OPR] Limits (as described above) can be made after the initial 12 months after your lifetime mortgage completes and will be treated in the same way except that you may have to pay an Early Repayment Charge, as described in Section 13.*”

In late 2019 Mr R raised a complaint with L&G about the way the mortgage operated. He explained that a year after taking out the mortgage he and Mrs R were in a position to repay the 10% of the initial loan they were allowed to pay without incurring an ERC. L&G confirmed the amount they could repay (£50,059.90).

Mr R called L&G again in November 2019 to make a further partial payment of £48,500 but was told he would have to wait until 24 August 2020 before this could be done. Mr R was unhappy about this and raised a complaint with L&G.

L&G didn't uphold the complaint and so Mr R brought it to the Financial Ombudsman Service, where an investigator looked at it. She didn't think the complaint should be upheld. She was satisfied the mortgage documentation was clear about partial repayments. The investigator also explained that the account wasn't split into capital and interest, and that there was no obligation on L&G to change the way the product operated.

Mr R asked for an ombudsman to review the complaint. Mr R believes that *"there is not one clause that states we cannot keep the loan at a manageable size by clearing the interest..."*. Mr R says that L&G is making enough profit on the fixed interest rate of 5.33% to make it worthwhile, without *"grabbing"* more on compound interest. This is *"sleight of hand and we feel it is our duty to draw this to public attention and stop this surreptitious extra profit source. When [L&G] arrived at the figure of 5.33% on a sum of just over half a million pounds worth of borrowing it should have stated in black and white that the true profit margin was based on the half a million and also the compound interest factor as well..."*

Mr R says that, according to the annual statement, interest of £25,501.54 had accrued, which made the debt £526,100.54, but he was only able to repay £50,059.90, which was 10% of the original loan, not 10% of their indebtedness. This, he argues, shows that L&G separates out the capital from the interest and, furthermore, nowhere in the documentation does it state that you cannot pay off the interest. Mr R also argues that this *"bars the prudent investor from escaping spiralling debt and as a consequences putting the borrower in an unnecessary entrapped slavery to their iniquitous exponential debt pressure – which is not how the adverts portray the scheme working..."*

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.

I apologise for the length of time Mr and Mrs R have been waiting for a decision on their complaint. I will begin by saying that the Financial Ombudsman Service is not an industry regulator, and we have no power to tell L&G what products it should sell, or what interest rates it should set. The Financial Ombudsman Service is also not a court, and it is outside our powers to decide whether or not a contractual term is unfair or unenforceable – only a court can determine this.

Equity release products have been offered to the market for more than 30 years. Even before mortgage regulation came into effect in October 2004, equity release products were subject to strict selling standards, with documentation which set out explicitly how the loans operated, and how ERCs would be applied. That's because lenders could see the potential for elderly customers (or their relatives) to complain, years after the event, about the products. After mortgages became regulated products, the documentation was put into the format prescribed by the regulator, which is now the Financial Conduct Authority (FCA).

The product is structured to reflect the fact that L&G has lent money over a long term in the expectation that it will receive no return on its funds until the mortgage ends – which could be in 25 or 30 years from the date it was taken out. The implications of this on the overall amount owed are explained clearly in the documentation. So when an equity release contract is entered into, L&G advances the funds in the knowledge that it will expect to receive no payment for many years – and the borrowers know they have the use of the money without needing to make any repayment.

The crux of the complaint is that, although Mr R acknowledges how the OPR operates, he thinks the way the product is set up is unfair. Mr R argues that the fact that only capital can be repaid as an OPR supports his contention that L&G *does* separate out capital from

interest. As such, Mr R can see no reason why he can't repay interest in order to keep the debt from increasing. Mr R says that nothing in the mortgage documentation says that interest can't be repaid.

The OPR is clear that up to 10% of the amount borrowed can be repaid in every 12-month period from the first anniversary of completion of the mortgage. The mortgage documentation (including the brochure giving detailed information about the product) says that any OPR will affect the amount on which interest is charged – which means it will reduce the capital balance. Any amount paid in excess of the annual 10% allowance will also be applied in this way. So I think it's clear from the documentation that payments will be applied towards reducing the amount borrowed. I say this because the "*amount borrowed*" is the sum advanced by L&G. Interest on this sum is not an "*amount borrowed*". So although Mr R says that there is nothing which says he can't repay interest, I disagree. The information about OPRs in both clauses 13 and 14 are clear that any OPR is applied towards the "*amount borrowed*".

This is the product which Mr and Mrs R took out, after being given advice by their IFA. Mr R has confirmed that this was the most suitable for them at the particular time they needed it. He acknowledges that in 2018 they had no prospect of paying off the loan at all, let alone paying off 10% annually – although equally he and Mrs R knew that events could change for them, which they did within 13 months of taking out the loan. Given this, a loan which didn't provide for any repayment of interest wouldn't have been something that concerned them in 2018. Now their situation has changed, they are unhappy that they can't pay interest off the loan. I understand why, given the overall cost of the mortgage, Mr R has gone through the documentation to see if there is a loophole which will allow repayment of interest. I'm satisfied that the contractual terms are clear, and that OPRs are applied to the amount borrowed, not interest applied to the amount borrowed.

L&G is under no obligation to separate out the mortgage into two separate accounts of capital and interest and allow Mr and Mrs R to make payments against whichever account they choose. I appreciate Mr R thinks this is how the mortgage account should operate, but it doesn't work like that.

Mr and Mrs R's mortgage offer is in the regulator's prescribed format, which shows (amongst other things) how accrued interest will increase the overall debt, when and how OPRs can be made, and where an ERC will be applied. I see Mr R wants L&G to change the wording of the documentation. However, L&G has to ensure its documentation is FCA-compliant and uses terminology approved by the regulator. Consequently L&G isn't required to tailor its mortgage offers to include wording suggested by its customers.

Mr and Mrs R accepted this L&G product on the terms offered, and so they have a binding contract with L&G on those terms. If the contractual terms are not now to Mr and Mrs R's liking, then they are, of course, free to repay the mortgage, subject to any ERC that may be due to L&G. If they want an equity release mortgage that allows them to make repayments of interest, this type of product is available and Mr and Mrs R's financial advisor will be able to help them with this, if they decided to move the mortgage from L&G.

I've noted Mr R's comments about the need to draw the attention of the general public to how equity release mortgages operate, and that the reality (as he sees it) is very different from what he says is the rosy picture portrayed in advertisements. I have no doubt about Mr R's strength of feeling about this, but the Financial Ombudsman Service is not a consumer champion. We are independent and impartial, and as such it is outside our remit to comment on this or address how equity release mortgages are advertised. Mr R is free to raise his concerns about any advertisement he considers to be misleading with the Advertising Standards Authority, if he wishes to do so.

I know this isn't the outcome Mr and Mrs R wanted, but I'm unable to find L&G has done anything wrong. As I said at the outset, I have no power to tell L&G how to structure its products; this mortgage meets the regulator's requirements, and it's outside my powers to interfere with the contractual terms agreed to between L&G and Mr and Mrs R. There is, in my opinion, nothing inherently unfair in L&G applying overpayments towards reduction of capital and I find no ambiguity in L&G's documentation stating that it will apply OPRs to reducing the amount borrowed.

Mr and Mrs R are under no obligation to accept my decision – and if they decide not to, it won't be legally-binding on them or L&G, leaving Mr and Mrs R free to pursue their concerns against L&G in court, if they wish to do so.

My final decision

My final decision is that I don't uphold this complaint.

This final decision concludes the Financial Ombudsman Service's review of this complaint. This means that we are unable to consider the complaint any further, nor enter into any correspondence about the merits of it.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs R and Mr R to accept or reject my decision before 18 May 2021.

Jan O'Leary
Ombudsman