DRN-3701445

The complaint

Mr and Mrs L's attorneys, on their behalf, complain that the early repayment charge (ERC) on a lifetime mortgage with Prudential Lifetime Mortgages Limited is too high.

What happened

In 2008, Mr and Mrs L took out a lifetime mortgage with Prudential for £700,000 with a fixed interest rate of 6.68%. The mortgage offer stated that an ERC would apply for 18 years from the date the mortgage was taken out and would be calculated from:

1. The fall in the Bank of England (BoE) base rate from when the mortgage started to the date the mortgage is repaid.
2. The remaining term on the mortgage.
3. The balance on the date of repayment, including interest and charges.

The ERC would be 1 multiplied by 2 multiplied by 3.

In June 2020, Mr and Mrs L asked Prudential about downsizing to a smaller home and transferring the mortgage to avoid the ERC. It provided an illustration for a loan of £766,080 against a property valued at £1.2 million – a loan-to-value of 64%. Mr and Mrs L wanted to reduce their balance further – but they were told if they did so then Prudential would apply the ERC.

Mr and Mrs L repaid their mortgage with Prudential, with an ERC of £175,000 applied. They took out a new lifetime mortgage with a different lender.

Mr and Mrs L's representatives complain:

- The 2008 mortgage offer said that Mr and Mrs L could transfer the mortgage to another property and reduce the balance without paying an ERC. It did not say that they could only reduce the balance to a new maximum amount set by Prudential. Mr and Mrs L had not agreed to any variation of the terms of the mortgage. The updated 2020 terms don't set out the circumstances in which Prudential would require a partial repayment. If there is any doubt as to the meaning of the terms, the interpretation that is most favourable to the consumer should be applied.
- The mortgage offer says that as an alternative to transferring the mortgage, Mr and Mrs L "*may be able to get a new lifetime mortgage*". But Prudential no longer offers lifetime mortgages, so that was not possible. Mr and Mrs L took the mortgage in good faith, believing that Prudential would honour its terms. There was no warning that Prudential would stop offering lifetime mortgages.

- The ERC is excessively high and not a reasonable pre-estimate of the cost of repaying the mortgage early. The ERC has been at the maximum possible amount of £175,000 since 2009. The term remaining on the mortgage has no impact on the amount. So the ERC is effectively a flat fee and the term of the mortgage has no influence on that. An amount that does not alter over 11 years can't be a reasonable pre-estimate of the cost of repaying the mortgage early, as that should change over time.

- The interest rate of 6.68% is very high compared to most lifetime mortgages available now. And most lifetime mortgages offer greater flexibility. Mr and Mrs L were locked into a contract with rigid terms and no option to renegotiate or take out a new lifetime mortgage. So Mr and Mrs L were left with the option of transferring the loan that would cost them around £50,000 in interest or repaying the mortgage and incurring an ERC of £175,000.

- It was irresponsible for Prudential to insist on a loan-to-value of over 60% if the mortgage was transferred.

- The wording of the 2008 mortgage offer was unclear – and the changes Prudential has made were not in Mr and Mrs L's best interests.

- While the mortgage might be intended to last a lifetime, that should not be used to bind older customers into terms they can't change, particularly as there are many unforeseen circumstances that can affect older consumers.

- This matter has had a significant impact on Mr and Mrs L both financially and on their health.

My provisional decision was to uphold the complaint in part. My provisional findings, which form part of this decision, were:

<u>Mortgage terms</u>

It's clear that Prudential made an error when it told Mr and Mrs L that the minimum mortgage balance they could transfer to another property was equivalent to a loan-to-value of 64%. I will deal with that later. The offer actually said that the maximum loan amount was equivalent to 35% loan-to-value and that "If you transfer your mortgage to a new property and the amount of your maximum loan value reduces as a result, you may have to repay the difference between the amount you owe us and the new maximum amount that you can borrow and pay an early repayment charge..." I consider the offer was reasonably clear that no ERC was payable if the loan-to-value on the new property was 35% or more.

Prudential's final response said that it had changed the way that it had administered transfers and that allowed borrowers to transfer a higher balance across. That might have been beneficial for some customers. But it wasn't for Mr and Mrs L as they wanted to reduce their balance. And it didn't reflect the terms of the mortgage offer that Mr and Mrs L had accepted.

I don't consider the terms of the 2008 mortgage offer were unfair. But Prudential acted unfairly by not applying those terms when Mr and Mrs L explored transferring their *mortgage. It ought to have told them that they could reduce their borrowing to 35% loan-to-value.*

Prudential no longer lending

I accept the offer said that Prudential "may" offer new products. But I don't see how that could be taken as an irrevocable undertaking that it would always do so. As far as I can see, the mortgage operated in line with the terms that Mr and Mrs L agreed to. There was no obligation for Prudential to offer then a different product.

ERC

The ERC was set out clearly and prominently in the mortgage offer. I'm satisfied that Mr and Mrs L agreed to the terms of the mortgage, including the ERC, when they took it out. Prudential acted in line with the offer when in applied the ERC when the mortgage was repaid.

The ERC was based on any reduction in the BoE base rate, the remaining term and the mortgage balance. Prudential has provided evidence that it carried out such a calculation. The amount was considerably over £175,000 – so it applied the maximum ERC of £175,000 in line with the mortgage offer.

Under the relevant regulations Prudential could only apply an ERC if it was a reasonable pre-estimate of the cost to it of the mortgage being repaid early. I'd note that it was only required to be a reasonable estimate. If the actual costs were more or less than the estimate it wouldn't necessarily follow that the ERC was unfair.

I consider the method used by Prudential to estimate the ERC is reasonable. I say that because when it granted the mortgage it expected to earn interest on it at the fixed interest rate for 18 years. There were exceptions to that – but ultimately it lent the money on the basis that it would receive interest over that period. If the mortgage was repaid before that Prudential would be able to lend the money again. But it would be unable at the mortgage's inception to predict whether interest rates would go up or down during the period in question. So there may be an ongoing loss in maintaining fixed liabilities if it could only lend the money at a lower interest rate. If interest rates had gone up, it wouldn't suffer any loss as it could lend the money at a higher interest rate. But if interest rates had gone down, it would usually only be able to lend the money at a lower rate. There are likely to be other costs of funding the loan to Prudential.

The method used by Prudential uses the BoE base rate as a proxy for any fluctuations in the costs of borrowing and lending. It is likely that the actual cost to Prudential would be different. Many lenders use a variety of different sources to fund mortgages. But I consider the BoE base rate is a reasonable basis on which to estimate the cost to Prudential as it reflects the cost of lending and borrowing generally. And it is a more accessible reference point for consumers than using other financial instruments that might be more complicated and not as well publicised. I am satisfied that Prudential took the remaining term into account in its calculation – and the actual amount was in excess of the £175,000 charged.

I understand why Mr and Mrs L and their representatives were shocked at the amount of the ERC. I know it won't be any comfort for them, but it is entirely due to the historic and unprecedented reduction in interest rates since Mr and Mrs L took out the mortgage. But I don't think it follows that the ERC was unfair.

Putting things right

It is clear that Prudential made a mistake here. It should have told Mr and Mrs L that they could reduce their mortgage to 35% of the value of the new property. Where a business has made a mistake, we try to put the affected party back in the position they would have been in had they been given the correct information.

As I see it, Mr and Mrs L would have had three choices:

1. *Transfer their mortgage to a new property at 35% loan-to-value. If Mr and Mrs L had done that, they would have continued to pay 6.68% compound interest until at least 2026. There would have been no ERC.*

2. *Repay the mortgage and taken a new mortgage at a lower interest rate. They would have had the benefit of a lower interest rate. The ERC would have been £175,000.*

3. *Repay the mortgage and buy a new property mortgage free. There would be no interest to pay. The ERC would have been £175,000.*

Mr and Mrs L's representatives said that they were as sure as they reasonably could be that Mr and Mrs L would have chosen option 1, because that was their original plan and they always intended to downsize and reduce the loan. And that is also what they were advised to do by an equity release adviser.

Mr and Mrs L's representatives said if Mr and Mrs L had been able to transfer the mortgage at 35% loan to value on a lower valued property that would have given them much more flexibility. It would have allowed them to buy a property valued at around £900,000 and they would have been able to move without having to rent for a time.

Mr and Mrs L's representatives provided a breakdown of the financial loss they said Mr and Mrs L suffered by not being able to port the mortgage at 35% of the value of a new property. They consider that Mr and Mrs L would have been better off overall had they done that.

I put what Mr and Mrs L's representatives to Prudential. It said that Mr and Mrs L contacted it in May and June 2020 to ask for details of the loan balance, interest rates and information about moving. It produced an illustration showing the amount that they could transfer to the new property based on the loan to value of the mortgage at that time. That was on a purchase of a property at £1.2million. Prudential said it wasn't made aware that Mr and Mrs L were considering a lower value property. It said in July it was contacted again and asked what impact a partial repayment would have had. The loan was fully repaid in November 2020.

When it became clear that Mr and Mrs L wanted to reduce their loan as much as possible, Prudential said that it could have offered them the chance to move based on the original loan to value of 35% - but that would have significantly increased the amount they would have had to repay on moving.

Prudential said that if Mr and Mrs had ported the lower loan to value loan they would have had to repay over £340,000 more. Had Mr and Mrs L chosen to move and then repay the mortgage then they would have had to pay an ERC of £105,000. That is £70,000 less than the ERC they paid and is the basis of its offer.

I think Prudential's offer is based on a scenario that was unlikely to have happened. Based on what we have seen, I can't see that it is likely that Mr and Mrs L would have chosen to downsize to avoid the ERC and then moved again and incurred an ERC.

On the other hand, I think it is difficult for me to say that the decision taken by Mr and Mrs L would necessarily have been any different had they been given the correct information by Prudential. While they may have been considering properties with a lower value, their representatives have pointed out that there was a lack of properties on the market at the time in question and there is likely to have been competition for properties. And I can see why repaying in full an equity release mortgage with compounding interest would be attractive for Mr and Mrs L.

I'm not sufficiently persuaded that Mr and Mrs L would have been able to achieve the scenario set out by their representatives. That seems to me to be the maximum amount they might have lost compared against a set of circumstances that might not have been achievable in the necessary timescales. Nor is it clear what Mr and Mrs L would have done had Prudential acted fairly.

It's clear that Mr and Mrs L had a number of different options available to them. It was their decision to take the steps they did. I consider would be difficult for me to put together a persuasive argument that the position they found themselves in was solely as a result of any mistakes made by Prudential.

That is not to say that Prudential has acted fairly in this case. I agree that its actions have contributed to the position that Mr and Mrs L have found themselves in. Looking at all of the circumstances and thinking carefully about what both their representatives and Prudential have said and provided, I consider that £70,000 is a fair amount to reflect any financial loss they have suffered.

That leaves compensation for the distress, inconvenience, pain and suffering suffered by Mr and Mrs L as a result of what happened.

I asked Mr and Mrs L's representatives to set out the impact of this matter on Mr and Mrs L. They said that Mr and Mrs L:

- *Were forced to move into a flat rather than a house and that meant they weren't able to retain certain possessions and pursue other interests due to a lack of space. That has caused them a lot of upset and has deprived them of pleasure.*
- *Suffered two years of stress and anxiety in having to move twice and in having to deal with this ongoing complaint, which Prudential has prolonged.*
- *The stress has had damaging and destructive impact on Mr and Mrs L's health. They have gone from "relatively sprightly to loss of health and peace of mind".*

I've already found that Prudential isn't entirely responsible for the situation Mr and Mrs L are in – that is partly at least due to decisions they made. For example, it was their decision to move and they may not have been able to complete a new purchase in line with the sale of their property. So all of the impact of moving is not something I could reasonably say that Prudential was responsible for.

But I accept that Prudential's acts or omissions meant that they weren't able to make a fully informed decision about what to do. That will have caused them some distress. I also accept that Mr and Mrs L were elderly and had serious health concerns. Prudential's acts *or omissions will have caused them stress and anxiety – and I accept that is likely to have had an impact on their health over a period of more than two years while this matter was ongoing.*

And while Prudential is not entirely responsible for Mr and Mrs L's situation, it is likely to have contributed to it and again I accept that it will have caused them some upset.

Overall, considering what we know about the impact of this matter on Mr and Mrs L and the length of time they have suffered because of Prudential's acts or omissions – but taking into account that some of those things are due to decisions taken by Mr and Mrs L – I consider it would be fair for Prudential to pay them £1,000 to reflect the distress, inconvenience, pain and suffering this matter has caused to them.

I proposed that Prudential should honour its offer to pay Mr and Mrs L £70,000 and that it should increase the compensation for distress, inconvenience, pain and suffering to £1,000.

Prudential accepted my provisional findings. Mr and Mrs L's attorneys made a number of points, including:

- If there were other options available to Mr and Mrs L, including reducing the LTV to 35%, Prudential should have told them that – and it isn't clear why it didn't do so. Prudential didn't recognise its mistake when the complaint was first made in September 2020. If it had done so Mr and Mrs L would have had time to consider their options.

- Mr and Mrs L had no way of knowing that Prudential would accept a 35% LTV – and they relied on the information from Prudential that the initial amount was the only amount that could be ported to another property.

- Prudential hasn't apologised.

- The impact of Prudential's mistake was to compel them to buy a significantly smaller property than if they had ported and to lengthen the time it tool to find a property that was affordable for them. The stress and damage to health far exceeds £1,000 – particularly as Prudential could have rectified its mistake in September 2020 or admitted it in December 2020. Instead it subjected Mr and Mrs L to a lengthy referral to our service.

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've looked at everything again – including the response from both sides to my provisional decision. Having done so, I see no reason to reach different findings that I did in my provisional decision – other than telling Prudential it must apologise to Mr and Mrs L.

Prudential didn't act fairly or reasonably in not giving Mr and Mrs L all of the information they needed about the amount they could port to another property. I accept if it had acted fairly then Mr and Mrs L would have had been able to consider other options when they were deciding what to do.

But I don't consider that the evidence we have is enough for me to say that that the decision taken by Mr and Mrs L would necessarily have been any different had they been given the correct information by Prudential. While they may have been considering other properties, their representatives have pointed out that there was a lack of properties on the market at the time in question and there is likely to have been competition for those that were on the market. And I can see why repaying in full an equity release mortgage with compounding interest would be attractive for Mr and Mrs L.

Overall, I consider that Prudential's offer of £70,000 is a fair amount to reflect any financial loss that Mr and Mrs L have suffered. I agree that Prudential should also apologise to Mr and Mrs L.

I have thought carefully about the compensation for distress , inconvenience, pain and suffering caused by Prudential's mistake. I note what Mr and Mrs L's representative has said. But I've already found that Prudential isn't entirely responsible for the situation Mr and Mrs L are in – that is partly at least due to decisions they made. For example, it was their decision to move and they may not have been able to complete a new purchase in line with the sale of their property. So the total impact of moving on them is not something I could reasonably say that Prudential was responsible for.

But I accept that Prudential's acts or omissions meant that they weren't able to make a fully informed decision about what to do. That will have caused them some distress. I also accept that Mr and Mrs L were elderly and had serious health concerns. Prudential's acts or omissions will have caused them stress and anxiety – and I accept that is likely to have had an impact on their health over a period of more than two years while this matter was ongoing.

And while Prudential is not entirely responsible for Mr and Mrs L's situation, it is likely to have contributed to it and again I accept that it will have caused them some upset.

After careful consideration, I still consider that £1,000 is a fair amount to reflect the distress, inconvenience, pain and suffering caused to Mr and Mrs L by Prudential. I accept that might not reflect all of the distress, inconvenience, pain and suffering they experienced. But I consider it is a fair amount to reflect that caused where Prudential hasn't treated them fairly or reasonably.

My final decision

My final decision is that Prudential Lifetime Mortgages Limited should:

- Honour its offer to pay Mr and Mrs L £70,000 in respect of the ERC it applied.
- Pay Mr and Mrs L £1,000 to reflect the distress and inconvenience this matter has caused to them.
- Apologise to Mr and Mrs L.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr L and Mrs L to accept or reject my decision before 12 October 2022.

Ken Rose
Ombudsman