

The complaint

Mr S and Ms D have complained about the early repayment charge (“ERC”) they incurred when they redeemed their mortgage with Barclays Bank UK PLC.

They feel it is unfair that such a large ERC was charged when their fixed rate mortgage product was so close to the end of its term.

What happened

Mr S and Ms D took out this mortgage in June 2018. The mortgage offer dated 16 May 2018 indicated they were borrowing £427,500 (plus fees) over a 31-year term on a repayment basis. The rate was fixed at 2.44% until 31 July 2023, with an ERC being due if the mortgage was repaid before that date.

The ERC was explained as being 3% of the amount repaid, with the cash example given as £12,855.

In July 2022 Mr S and Ms D were looking at moving house and spoke to Barclays about porting their existing mortgage and taking the extra borrowing they needed on a tracker rate, with the plan being to then rearrange both parts of the mortgage once the ERC period ended on the fixed rate.

As interest rates started to rise Mr S and Ms D decided to instead look for a new fixed rate for all their borrowing, as they were concerned about what rates might be available if they left it until 2023 to rearrange their existing fixed rate. They asked Barclays to waive the ERC on their fixed rate, and when Barclays wasn’t willing to do so Mr S and Ms D arranged a new mortgage elsewhere and redeemed their Barclays mortgage. In doing so they incurred an ERC of £10,350.

Mr S and Ms D complained to Barclays about the ERC, and Barclays didn’t uphold the complaint.

One of our Investigators looked at the complaint. He said the ERC was outlined in the mortgage offer, and it isn’t calculated just on the amount of interest that would have been charged for the remaining term.

Mr S and Ms D didn’t agree with our Investigator’s findings and so the case was passed to me to decide.

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 recognise that Mr S and Ms D feel very strongly about this, and I thank them for the thoroughness of their submissions. I won’t detail everything that they’ve said, however I can assure them that I’ve read and understood everything and taken it all into account. If I don’t

comment on any specific point it's not because I've failed to consider it but because I don't think I need to comment on it in order to reach what I think is the right outcome.

I've carefully considered the legal arguments Mr S and Ms D have made. But the Financial Ombudsman Service is an informal alternative to the courts. It may be the courts would look at this matter differently, but my role is to concentrate on what I consider fair and reasonable. If Mr S and Ms D feel their claims have merit, then they can test that in court if they wish.

Mr S and Ms D have talked about this being a penalty for them breaching the contract. But, when Mr S and Ms D's mortgage was repaid, there was no breach of contract. That's because the contract allowed for the mortgage to be repaid if Mr S and Ms D paid an ERC.

We're not the regulator, and I've no power under our terms of reference to comment on, or otherwise determine, how financial businesses operate in general terms. I have to consider this complaint by reference to Mr S and Ms D's particular situation. When I do that, I'm satisfied the terms of the ERC were set out in the mortgage offer in a way that should have been readily understandable to Mr S and Ms D; certainly, the information about the ERC was set out in a manner that met the regulator's requirements. So I'm persuaded Mr S and Ms D knew – or at least should have known – how much they'd have to pay as an ERC if they repaid the mortgage before 31 July 2023.

That said, I need to decide what is fair and reasonable in the individual circumstances of the complaint. The rules we operate under say that in doing that I must take into account, amongst other things, the relevant rules and regulations. In this case that is the Financial Conduct Authority's Mortgages and Home Finance: Conduct of Business sourcebook (MCOB).

MCOB includes provisions about ERCs in MCOB 12.3 which can be viewed at www.handbook.fca.org.uk/handbook/MCOB/12/3.html

In summary, those provisions say that an ERC must be able to be expressed as a cash value and must be a reasonable pre-estimate of the costs resulting from early termination of the mortgage. But a lender can choose how it calculates an ERC and can calculate the same level of ERC across a group of mortgages of similar type, rather than for individual loans.

Barclays is entitled to set an ERC based not on the actual cost to it of Mr S and Ms D ending their own mortgage early, but on a reasonable pre-estimate of the costs of early termination of a group of mortgages of similar type.

Lenders generally raise money to offer preferential rates for their mortgage customers on the wholesale money markets. There's a cost to that, and it's generally fixed in advance. But the lender expects to receive a return to outweigh those costs. If a mortgage ends early, it doesn't get back all the returns it expected, and so doesn't make back the costs in raising the funds to offer that preferential rate.

It's complex and onerous for lenders to calculate individual losses as and when individual customers decide to terminate their contracts early. And it isn't possible to estimate, for any given individual, when or if they might do so. So Barclays is allowed to project how many customers, on average, are likely to terminate early and, on average, at what point they're likely to do so, and to apportion that cost across the mortgages in the group. For some individual mortgages that will end up being an over-calculation, and for others it will be an under-calculation. But that's allowed; Barclays doesn't have to refund the difference, but equally it doesn't tell a consumer to pay the difference if it goes the other way.

The ERC is expressed as a cash value in the mortgage offer. So I've considered whether the ERC was a reasonable pre-estimate of the cost of the mortgage being repaid early.

Barclays has provided us with evidence to show how it pre-estimated the costs of this group of mortgages being repaid early. Under our rules I am allowed to accept evidence in confidence if it is appropriate to do so. I am satisfied that the information Barclays has provided is commercially sensitive and I have good reason to accept that in confidence and so I won't be disclosing it to Mr S and Ms D.

The information from Barclays shows that it takes into account a number of factors when estimating the cost of a fixed rate mortgage being repaid. It has provided a breakdown of the figures it used and an explanation for the calculations and estimates it has made. It shows that the ERC reflects its costs of funding the fixed rate, the cost of financial instruments that could be used to protect its position (and unwinding those) and its future losses. I've looked carefully at what Barclays has said and I consider it is a fair way to calculate the ERC.

As I've explained above, the ERC isn't set based on the unrecoverable interest costs for each mortgage in isolation as that wouldn't be possible to know in advance and the ERC must be known in advance as it must be shown in the mortgage offer. It also takes into account other unrecoverable costs.

Barclays couldn't have known, in 2018, that Mr S and Ms D would choose to end their mortgage early, when they would choose to do so, and that interest rates would be at the level they are now at the point Mr S and Ms D chose to end the mortgage. Equally, things could have gone a different way, with Mr S and Ms D choosing to end their mortgage right at the start of the product term and at a time interest rates were lower than when they took out their mortgage. In that instance Barclays wouldn't make Mr S and Ms D pay more to cover any additional potential losses, and equally Barclays isn't expected to refund any difference if it goes the other way.

As I said above, in some instances the ERC will be "too much" and in others it will be "too little". That is allowed under the rules as long as, at the point it was set, the ERC was a reasonable pre-estimate of the potential loss the lender would incur in line with the regulatory guidance in MCOB. Here I'm satisfied it was.

Having considered everything, I'm satisfied:

- Barclays was entitled to charge Mr S and Ms D the ERC set out in their mortgage contract when they repaid their mortgage early.
- There was no requirement for Barclays to only charge an amount worked out based on Mr S and Ms D's individual loan and date of redemption, instead it was allowed to charge an amount based on its pre-estimate of the costs of early termination of a group of mortgages of similar type.
- Barclays didn't have to treat Mr S and Ms D any differently to any of its other customers that redeemed their mortgage whilst there was an ERC in force.

For all the reasons given I don't think Barclays acted unfairly or unreasonably in this matter.

My final decision

I don't uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr S and Ms D to accept or reject my decision before 21 March 2024.

Julia Meadows

Ombudsman