

## **The complaint**

Mr and Mrs C complain about their mortgage with Nationwide Building Society. They're concerned that when they made overpayments their balance didn't reduce as expected.

## **What happened**

Mr and Mrs C have a mortgage with Nationwide, which they took out in 2007 over a 25 year term – ending in 2032. After their initial fixed rate ended, they've been on Nationwide's base mortgage rate. The base mortgage rate is a variable rate guaranteed to be no more than 2% above Bank of England base rate.

In 2018, when the interest rate reduced, Mr and Mrs C asked Nationwide not to reduce their monthly payment, so they've been paying extra each month. They've also made small overpayments from time to time – generally under £200 each month in addition to the regular payment.

Mr and Mrs C calculate that overall they've paid the equivalent of around four years' worth of monthly payments. So they expected the term of their mortgage to reduce by around the same amount.

In 2023 Mr and Mrs C asked Nationwide to apply the overpayment reserve they'd built up to their mortgage to reduce the balance. They were surprised when Nationwide said that as a result the term would only reduce by three months.

Mr and Mrs C complained. They didn't think that Nationwide had properly accounted for their overpayments or explained where the money had gone. They didn't understand why around £15,000 of overpayments in total would only reduce their balance by three months and didn't think that could be correct.

Nationwide said that when a customer made overpayments it would re-calculate the monthly payments to ensure the mortgage was repaid over the same term by default. But it had noted that Mr and Mrs C wanted a term reduction instead – but it only reduced the term where overpayments of more than £500 were made. It didn't agree it had made an error in the balance. But it offered £75 compensation for delays in arranging for a mortgage adviser to explain what had happened.

Our investigator didn't think that Nationwide had mis-calculated the balance. But she thought that it ought to have explained things better, and said it should increase the compensation to £350. Neither party agreed with that, so the complaint comes to me for a final decision.

## **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'm satisfied the past overpayments have been properly accounted for. Because Mr and Mrs C didn't make an overpayment of more than £500 above their contractual payment in

any given month, Nationwide didn't reduce the term.

I don't think that's unreasonable. Where a large lump sum payment has been made, I would expect Nationwide to discuss with a borrower whether they want to reduce the term or the monthly payments. But where small regular overpayments are made, I don't think it's unreasonable that Nationwide doesn't review and re-calculate the mortgage term every month.

When an overpayment – large or small – is made, Nationwide reduces the balance immediately, which reduces the interest charged (and increases the capital repaid as a proportion of the same payment) in future months. And whenever the interest rate changes – which it has done several times since 2018 – Nationwide calculates the new monthly payment based on the balance on that day and the existing term.

That's why when interest rates increased from 2021 onwards, Mr and Mrs C's contractual monthly payment actually went down not up. Whenever the interest rate changes, the contractual payment is changed based on the balance and term at that date.

Because of the overpayments they'd made, the effect of this was that they needed to pay less each month to clear the balance by the end of the term – even though interest rates had increased. If they hadn't made the previous overpayments, a change in interest rate would result in an increased not a reduced monthly payment. But as interest rates have risen, and Mr and Mrs C have continued to pay £315 per month, the amount of that payment which is an overpayment has reduced again.

As a result, the balance and monthly payment were lower than they would otherwise have been. For example, in March 2023, if Mr and Mrs C had never made any overpayments their balance would have been £29,441 and their monthly payment would have been £378. But because of the overpayments they'd made, their balance was £23,600 and their monthly payments were £284 – meaning that the amount they were paying of £315 per month was still an overpayment and still reducing their balance more quickly.

Mr and Mrs C might have made overpayments totalling around £15,000 over the years since 2012. But paying small amounts each month over ten years or more doesn't have the same effect as paying a single lump sum of £15,000 in one go. The smaller regular overpayments have reduced Mr and Mrs C's balance, and have reduced their monthly payments – meaning that they're now paying less each month than they would have done otherwise, and that this smaller amount is still an overpayment and still reducing their balance.

The effect of Nationwide treating overpayments of less than £500 per month in this way is that while there isn't a substantial reduction in the mortgage term, it's cheaper to pay the mortgage off – because less interest is charged and less needs to be paid each month.

When Nationwide discussed the account in 2023 and told Mr and Mrs C that the term would reduce by around three months, this wasn't because of overpayments they'd made in the past. Those overpayments had been used to reduce the interest charged, and the contractual monthly payments, each month. Rather, this was a projection, based on the balance at that time, and how much sooner it would be paid off if Mr and Mrs C continued to pay £315 per month rather than the contractual monthly payment as it was at that time. The past overpayments had already been factored into the balance and monthly payment, and so weren't also available to reduce the term.

The future projection also takes into account that Mr and Mrs C are continuing to pay £315 per month – although this is less than their monthly payment, the amount overpaid is less than it was, because of the impact of increased interest rates in the meantime.

Mr and Mrs C have an overpayment reserve of around £15,000 – this is the cumulative amount of overpayments they've made over the years. The existence of the reserve means they could choose to opt out of making mortgage payments for a time – as long as they don't underpay by more than they've overpaid.

But the reserve isn't a separate balance apart from the mortgage; the overpayments have been factored into the balance. So if Mr and Mrs C were to opt to underpay in the future their mortgage balance would increase (because interest would still be added but not be paid) and so the monthly payments required once they resumed making payments would be higher.

The reserve – the cumulative total of overpayments – is also not the same as the amount the capital balance has reduced by, because some of the overpayments were used to pay interest. Interest is calculated daily and then charged to Mr and Mrs C monthly. So if they make an additional payment on a different day on top of the increased regular payment in any given month, then the overpayment will be used to pay daily interest up to the date of that payment, and the monthly payment used to pay daily interest from the date of the extra payment to the date of the monthly payment. And then in both cases the remainder of the payments will be used to reduce the capital. This has the effect that more of the monthly payment is used for capital, and less for interest, than would otherwise be the case.

### **Putting things right**

I appreciate Mr and Mrs C have found Nationwide's explanations confusing. But I'm satisfied it has treated their overpayments appropriately and Mr and Mrs C have benefitted from them. However, I agree with our investigator that it could have explained things better.

Nationwide says it makes clear on its website that it only considers immediate term reductions for overpayments of more than £500. But even so, I don't think it clearly explained to Mr and Mrs C exactly what had happened with their mortgage or why their payments had been treated in the way they had.

Nationwide has a responsibility to communicate clearly and fairly with its customers, and while this is a complex matter I don't think it did that. I'm satisfied that this caused Mr and Mrs C distress and inconvenience, because they didn't understand how their mortgage had been calculated and what had happened to the payments they'd made. I agree £350 is fair compensation in all the circumstances.

### **My final decision**

My final decision is that Nationwide Building Society should increase its offer of compensation to £350.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr C and Mrs C to accept or reject my decision before 8 April 2024.

Simon Pugh  
**Ombudsman**