

## The complaint

Mr and Mrs L have complained about the early repayment charge (“ERC”) they incurred when they moved their mortgage they hold with Barclays Bank UK PLC onto a new preferential interest rate product.

They feel the charge is excessive and unfair, and the ERC terms set out in their mortgage offer weren’t designed for their scenario.

## What happened

In 2016 Mr and Mrs L took out a Barclays mortgage on an interest rate fixed at 1.99% until 31 December 2023.

In 2021 they were moving house. They ported their existing Barclays mortgage interest rate product, and took the extra borrowing they needed on a new fixed interest rate. The application was made through an independent mortgage broker.

The mortgage offer dated 22 June 2021 indicated they were borrowing £670,499 over a 34-year term on a repayment basis. For the first £389,000 of the borrowing the rate was fixed at 1.99% until 31 December 2023, with the new borrowing of £281,499 being on a rate that was fixed at 1.08% until 31 August 2023.

The mortgage offer set out the ERC for each part of the mortgage as:

- Part 1 being 5% of the amount repaid until 31 December 2023, with the cash example given as £19,450.
- Part 2 being 2% of the amount repaid until 31 August 2023, with the cash example given as £5,629.

Following the mini-budget in September 2022 Mr and Mrs L instructed their broker to carry out an early rate change on both parts of the mortgage, moving them to a higher interest rate but with long term stability.

Barclays said Mr and Mrs L would need to pay the ERC as set out in the 2021 mortgage offer if they wanted to end their existing rates early.

Mr and Mrs L paid the ERC of £24,536 and Barclays issued the mortgage offer on 5 November 2022 for the new rate of 3.05% fixed until 31 January 2033. The rate switch took effect on 22 February 2023.

Mr and Mrs L complained to Barclays about the ERC, and Barclays didn’t uphold the complaint.

One of our Investigators looked at the complaint. She said the ERC was outlined in the mortgage offer, and she was satisfied Barclays had shown that it had met the regulatory requirements for it to be a reasonable pre-estimate of its loss (whether that be through the mortgage being redeemed, or by moving to a new interest rate product).

Mr and Mrs L 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 and Mrs L 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.

In resolving complaints, we determine what's fair and reasonable in the individual circumstances of the case – taking into account relevant law and regulations, as well as regulatory rules and guidance and good industry practice.

Although I take relevant law into account, specific findings of a breach of the Consumer Rights Act 2015 are more a matter for the courts than they are for me. I think the crucial question is whether Barclays acted fairly when it set the ERC at the level it did and then required Mr and Mrs L to pay that sum when they chose to come out of their preferential interest rate products early.

Mr and Mrs L have also quoted from PRIN 2.1 'The Principles' from the Financial Conduct Authority's handbook. Whilst I won't mention PRIN 6 specifically in the remainder of this decision I can reassure Mr and Mrs L that it is always something I keep in mind when deciding complaints like this as they are the underlying Principles at the heart of what we do – that is, decide what is fair and reasonable in the circumstances of a complaint.

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 and Mrs L'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 and Mrs L; certainly, the information about the ERC was set out in a manner that met the regulator's requirements. So I'm persuaded Mr and Mrs L knew – or at least should have known – how much they'd have to pay as an ERC if they ended their fixed interest rate products (whether that was due to them redeeming the mortgage or switching to a new preferential rate product) on or before 31 August 2023 and 31 December 2023 respectively.

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).

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 regulated mortgage contract. 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 and Mrs L ending their own mortgage contract early (whether that be through full redemption or due to them

choosing to take a new interest rate product), but on a reasonable pre-estimate of the costs of early termination of a group of regulated mortgage contracts of a 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 contract ends early (whether that be through full redemption or due to a customer choosing to take a new interest rate product), the lender 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 mortgage contracts in the group. For some individual mortgage contracts 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 contract being repaid early. Barclays has provided us with evidence to show how it pre-estimated the costs of both groups of mortgages being repaid early (that is the 2016 seven-year fixed rate and the 2021 two-year fixed rate). 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 and Mrs L.

The information from Barclays shows that it takes into account a number of factors when estimating the cost of a fixed rate mortgage contract ending early. 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 for both of the fixed rate products.

Mr and Mrs L have said that they weren't changing the amount financed, or the term of the mortgage, and they were switching to a higher rate. They say an ERC is primarily designed to protect the lender from lost interest, but in their case they will be paying additional interest as the new interest rate is higher, and the calculation doesn't provide a reasonable pre-estimate of Barclays' loss in that scenario.

The ERC isn't set based on the unrecoverable interest costs for each mortgage contract 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.

Even though Mr and Mrs L are existing customers and Barclays wouldn't be lending them any more money, it did (previously) and would (now) need to obtain money from the wholesale money markets. For the new rate it would need to obtain funds at a rate low enough to allow it to offer Mr and Mrs L a new regulated mortgage contract at the new interest rate to run until 31 January 2033. At the same time Barclays would need to unwind the deals it previously did when it lent money to Mr and Mrs L at interest rates that were fixed until 31 August 2023 and 31 December 2023 respectively.

Barclays can't afford to just transfer its customers onto new preferential rates without carrying out such deals, and there are costs involved in that. It's only right those costs are passed onto Mr and Mrs L when they chose to end their previous mortgage contract early. This is completely normal in the mortgage market when a consumer takes a fixed interest rate and not at all specific to Mr and Mrs L and/or Barclays. Whilst Mr and Mrs L wouldn't see it as it's an internal process, when taking a new interest rate they're – in effect – redeeming one mortgage contract and taking another and that triggers the payment of the ERC (even if the account number remains the same).

Barclays couldn't have known, in 2016 and 2021 respectively, that Mr and Mrs L would choose to end their preferential interest rate products early, when they would choose to do so, and that interest rates would be at the level they are now at the point Mr and Mrs L chose to end the mortgage. Equally, things could have gone a different way, with Mr and Mrs L choosing to end their preferential interest rate products right at the start of the product term and at a time interest rates were lower than when they took out their mortgage contracts. In that instance Barclays wouldn't make Mr and Mrs L 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 and Mrs L the ERC set out in their 2021 mortgage contract when they ended their preferential interest rate products early.
- There was no requirement for Barclays to only charge an amount worked out based on Mr and Mrs L's individual loan and date the products ended, 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 and Mrs L any differently to any of its other customers that ended their preferential interest rate products whilst there was an ERC in force.

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

Mr and Mrs L have raised some other points, such as the service they received as part of the application for the new preferential rate product and the new rate coming into effect months after they paid the ERC. As those didn't form part of the original complaint to Barclays I can't consider them here. That's because, under our rules, a business must be given the opportunity to investigate and respond to any complaint points before we can get involved. If Mr and Mrs L would like those points looked into then they will need to raise a new complaint with Barclays. If they are unhappy with Barclays' response to that complaint, Mr and Mrs L can then refer that new complaint to us (subject to our usual rules).

### **My final decision**

I don't uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr and Mrs L to accept or reject my decision before 22 March 2024.

Julia Meadows  
**Ombudsman**