DRN-4955032

The complaint

Mr K complains that Lloyds bank PLC has overcharged interest on his mortgages.

What happened

In 2008, Mr K took out six secured credit facilities with Lloyds. They were foreign currency mortgages and were payable in US Dollars. The interest on each mortgage was at 2.5% above Lloyds' cost of funds.

Mr K complains that the way Lloyds calculates interest is "*arbitrary, opaque, poorly defined and the calculation is devoid of transparency*". He also complains that Lloyds is calculating annual interest over 360 rather than 365 days.

I issued a jurisdiction decision explaining that I can only consider events after August 2017.

The investigator did not think the complaint should be upheld. Mr K did not accept what the investigator said.

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.

<u>Interest rate</u>

When Mr K took out the mortgages he accepted the offers and terms and conditions. The offers all said, as relevant:

Interest Rate

Interest on amounts outstanding under the Facility will be calculated at 2.5% per annum above the Bank's Cost of Funds (as hereinafter defined) with the Interest Period fixed for successive three months periods. Interest will be payable quarterly in arrears and on the last day of each interest period applicable to the currency of the Advance. The Bank's Cost of Funds means the cost (calculated to include the costs of complying with liquidity and reserve assets requirements) in respect of any currency expressed as a percentage rate of funding for maintaining the Advance or Advances in that currency as conclusively nominated by the Bank from time to time.

Mr K agreed to pay interest at 2.5% above Lloyds' cost of funds. I've explained in a separate decision that I can't consider events before August 2017. That would include how the loan was sold. But I consider it was clear from the offer that the interest rate was variable depending on what Lloyds' cost of funds were. Lloyds would apply a margin of 2.5% on top of its cost of funds.

Mr K considers that Lloyds calculates the interest rate unfairly – and it is unclear what constitutes its cost of funds. I agree that "cost of funds" is a broad term. But it is not unusual for lenders to take this into account when calculating the interest rate it charges borrowers.

That does not give Lloyds a free hand to charge whatever it wants. The cost of funds should be just that – the cost to Lloyds of funding the loans including any liquidity requirements. We have asked Lloyds for information to support that it has calculated its cost of funds fairly over the period in question,

Lloyds has told us that the information it has provided is commercially sensitive. I accept that – and our rules allow me to accept such information in confidence so that only a summary or description is provided to the other party.

Lloyds said its cost of funds is made up of two elements – the funding cost and the liquidity cost. In my experience, this is not out of line with how many lenders calculate their cost of funds and it is in line with what the mortgage offer says.

The funding cost is essentially the cost to Lloyds of raising funds. It has shown that its funding costs were broadly in line with external reference rates over the time in question – bearing in mind the currency of the loan and how often interest was applied. There is no evidence that Lloyds inflated its funding costs or that they did not reflect its actual costs. Its costs have gone up since 2022 after remaining relatively low since the mortgages' inception. But that reflects the increase in interest rates generally.

The liquidity cost is the additional costs incurred by Lloyds in raising funding to match the life of long-term lending. It has explained since the mortgages were taken out in 2008, there have been a number of factors that affected its liquidity costs, including revised liquidity rules following the "credit crunch", changes it its credit rating, the 2010-2012 European Sovereign debt crisis and further changes to liquidity regulation in 2014.

I accept that all of the above things contributed to either increased costs at the time in question or ongoing increased liquidity costs. But I would note that the liquidity cost has remained comparatively low during the period I am considering from August 2017.

Lloyds has told us that its liquidity costs reflect its actual costs. There is no evidence that its liquidity costs have been inflated or that it generates any profits from its liquidity costs.

Overall, I am satisfied that Lloyds has shown that it calculated its cost of funds fairly and reasonably and that it reviewed its costs of funds regularly. The recent increases largely reflect more widespread increase in interest rates. It follows that I don't consider the interest rate it applied on Mr K's mortgages was unfair. They have operated in line with the terms and conditions he accepted.

<u>Days interest</u>

The terms and conditions of the mortgage said interest would be calculated on the basis of a 365 or 360 day year, or on another number of days taken to constitute a year for the purpose of calculating interest in the relevant currency. Lloyds was not acting outside the terms of conditions in calculating interest over 360 rather than 365 days. And it is convention in USA for interest to be calculated over 360 days. Bearing in mind the currency of the mortgages was US Dollars, that seems fair and reasonable.

My final decision

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

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr K to accept or reject my decision before 30 September 2024.

Ken Rose
Ombudsman