

The complaint

Mr and Mrs N complain about the interest rate Mortgage Agency Services Number Five Limited (MAS5) has charged on their mortgage. They state the rate has been increased unfairly and for reasons not permitted by the terms and conditions.

Mr and Mrs N have brought their complaint with the help of a professional representative.

What happened

In July 2006, Mr and Mrs N took out an interest only mortgage. The mortgage offer said a fixed interest rate of 5.64% would apply to the mortgage until 31 March 2008. It said from 1 April 2008, the rate that would apply for the remaining term of the mortgage would be the lender's standard variable rate (SVR) (which was 6.49% at the time).

On 12 September 2022 Mr and Mrs N complained to MAS5 about the interest rate it had charged on the mortgage. They said MAS5 had increased the rate unfairly and not in line with other lenders, and MAS5 hadn't notified them of the rate changes over the years.

MAS5 issued a final response letter on 28 September 2022. It said that Mr and Mrs N's complaint about the interest rate charged more than six years ago had been made out of time. It said it had varied the interest rate in line with the terms and conditions of Mr and Mrs N's mortgage. And it had written to Mr and Mrs N each time the rate had changed.

MAS5 also said that since 31 March 2008, Mr and Mrs N had been free to redeem their mortgage without incurring an Early Repayment Charge. It said MAS5 is no longer an active lender which means it isn't accepting new customers or able to offer existing customers alternative interest rates or products. It said it had an appointment with Mr and Mrs N in March 2020 to discuss an application for an internal re-mortgage to another lender within the same banking group. But the application was postponed so Mr and Mrs N could obtain projected pension income figures to see if the mortgage would be affordable into retirement. It said it was yet to receive that information.

Further correspondence was exchanged between Mr and Mrs N and MAS5. And Mr and Mrs N complained about the increases to the interest rate again in September 2023. MAS5 issued a final response letter on 17 October 2023. It said that it had already addressed Mr and Mrs N's complaint about the interest rate in its previous final response letter. But it went on to explain that the changes it had made to the interest rate since September 2022 had been made following changes to the Bank of England base rate, which was allowed for under the terms and conditions of the mortgage.

Mr and Mrs N referred their complaint to our service on 14 January 2024. MAS5 said it didn't give our service consent to consider Mr and Mrs N's complaint about the interest rate charged more than six years before they complained. It agreed to waive the six month time limit set in the final response letter issued on 28 September 2022. It also made an offer to compensate Mr and Mrs N as if the interest rate they'd been charged on their mortgage between September 2017 and November 2022 was 1.25% lower than it actually was.

Our Investigator wrote to both parties to explain that she agreed our service only had the power to consider Mr and Mrs N's complaint about the interest rate charged in the six years before they complained. But she said that meant she could consider the period from 12 September 2016 onwards (rather than 2017 as MAS5 had done) – as Mr and Mrs N initially complained about the interest rate on 12 September 2022. The Investigator also thought the offer MAS5 had made to put things right was fair (subject to the dates changing to September 2016). But she thought MAS5 should also pay Mr and Mrs N £500 for the distress and inconvenience caused.

MAS5 accepted the Investigator's view but Mr and Mrs N didn't. Their representative said that Mr and Mrs N did not know that MAS5 had increased the interest rate on the mortgage for reasons that weren't permitted under the terms and conditions until he (the representative) had carried out extensive research. He said it was a complex matter and it's unreasonable to conclude that Mr and Mrs N ought reasonably to have known that there was a substantive complaint to be made, or that the lender had been taking advantage of them. He said they may well have been upset about the hikes, but that doesn't demonstrate an effective understanding of MAS5's conduct.

I issued a decision that said our service only had the power to consider Mr and Mrs N's complaint about the interest rate MAS5 charged from 12 September 2016 onwards. I will now set out my decision on the merits of the complaint.

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.

MAS5 has made an offer to settle Mr and Mrs N's complaint by re-working their mortgage account as if the interest rate they were charged between 12 September 2016 and 30 November 2022 was 1.25% lower than what MAS5 did actually charge. It says that would put right the higher rate Mr and Mrs N paid from September 2016 as a result of the increases it made to the SVR in 2011 and 2012. It doesn't think the redress should go beyond November 2022 as from that point, Mr and Mrs N have been charged a rate that is 1.38% less than what it would have been had it decided to pass on the full increases to the base rate that year. Mr and Mrs N dispute that redress is fair as it doesn't take account of all the increases made to the rate from 2009 onwards.

The SVR increases in 2009

Mr and Mrs N's mortgage was not taken out with MAS5 originally. In 2007 the mortgage was transferred to MAS5 by the originating lender. At the time of the transfer, there were certain terms that were agreed between the two businesses, one of which was an agreement that the SVR MAS5 charged on the mortgage would not be more than 2% above the Bank of England base rate. It's referred to this as the restrictive covenant. That term did not form part of the contract between Mr and Mrs N and the lender, it was an agreement between the two businesses and did not alter the original terms and conditions that Mr and Mrs N agreed to when they took out their mortgage.

The terms and conditions of Mr and Mrs N's mortgage said that the lender could vary the standard variable rate for the following reasons:

“(a) to reflect a change which has occurred, or which we reasonably expect to occur, in the Bank of England base rate or interest rates generally;

(b) to reflect a change which has occurred, or which we reasonably expect to occur, in the cost of the funds we use in our mortgage lending business;

(c) to reflect a change which has occurred, or which we reasonably expect to occur, in the interest rates charged by other mortgage lenders;

(d) to reflect a change in the law or a decision by a court; or

(e) to reflect a decision or recommendation by an ombudsman, regulator or similar body.”

Mr and Mrs N’s mortgage offer stated that the interest rate that applied to Mr and Mrs N’s mortgage would be a fixed rate of 5.64% until 31 March 2008, after which the SVR would apply for the remaining term of the mortgage. There was nothing in the terms that stated the interest rate would be linked to any particular reference rate, and it was not a tracker rate that would track movements in the base rate.

The Bank of England base rate fell significantly during 2008 and 2009, and as a result of the restrictive covenant, the SVR MAS5 charged to its mortgage customers, including Mr and Mrs N, reduced significantly too.

The agreement MAS5 had in place to charge an SVR no higher than 2% above base rate ended in 2009, and that is when it started to increase the SVR. MAS5 has said the increases made to the SVR in 2009 were because of an increase that had occurred in the cost of funds used in its mortgage lending business. It’s sent us evidence to support its arguments about that, but I’m not satisfied the evidence provided does show that MAS5’s cost of funds had increased at that time.

However, that isn’t the end of the matter. I also have to consider what is fair and reasonable in all the circumstances. Having done so, I’m not satisfied it would be fair and reasonable for MAS5 to reduce Mr and Mrs N’s interest rate as if those increases in 2009 had not taken place.

Whilst interest rates fell generally during 2008 and 2009 as a result of the financial crisis, the SVRs charged to mortgage customers within the banking group MAS5 operated in, as well as the wider market, did not fall by the same proportions as the base rate. That is for a variety of reasons, but generally the costs to firms of funding their mortgage business did not reduce by as much as the base rate did, and their prudential requirements changed.

Having considered the information MAS5 has sent us, as well as my knowledge and understanding of how the mortgage market was operating at that time, I think it’s likely that had the restrictive covenant not been in place during that period, the SVR MAS5 would have charged during 2008 and 2009 would not have reduced by as much as it did. As explained, there was nothing in the terms and conditions of Mr and Mrs N’s mortgage that linked the SVR to the base rate, and whilst the terms allowed MAS5 to vary the SVR following changes to base rate, they didn’t say it must do so.

The effect of the restrictive covenant therefore meant that the SVR MAS5 was charging its mortgage customers was lower than it would have been had the covenant not been in place. As a result, MAS5 customers received the benefit of paying a lower reversionary rate than they would have been charged by most other lenders at that time.

Whilst MAS5 may have increased the SVR when the covenant ended for reasons that weren’t permitted under the terms and conditions of Mr M’s mortgage, it was restoring the rate to what it would have been had the covenant not been in place.

It's important to remember that a complaint about the interest rate variations that took place in 2009 is actually out of time and our service doesn't have the power to consider it. I'm only taking account of what happened to the rate at that time as I think it's relevant to determine whether the rate Mr and Mrs N have been charged since 12 September 2016 is fair and reasonable.

While MAS5 may not have had any contractual justification for increasing the SVR once the covenant came to an end, I have to take all the wider circumstances into account when thinking about what's fair and reasonable more broadly during the period I can consider. And for the reasons I have given, I am satisfied that directing MAS5 to essentially deduct the 2009 increases from interest charged from September 2016 onwards would provide Mr and Mrs N with a level of compensation that I think goes beyond what is fair and reasonable in view of how long ago the changes were made, and the fact that those increases would not have been necessary had MAS5 been able to vary the rate in line with the terms and conditions Mr and Mrs N agreed to without the covenant in place. To do so would result in the interest rate after 12 September 2016 being lower than Mr and Mrs N could have expected it to be by operation of the mortgage terms and conditions alone, and would result in over-compensation.

The SVR increases in 2011 and 2012

MAS5 increased the SVR charged on Mr and Mrs N's mortgage in 2011 and 2012. The effect of both of those changes meant the rate went from 4.5% to 5.75%.

MAS5 said those increases were made as a result of the increases in the cost of funds used in its mortgage lending business. I am not satisfied that the evidence MAS5 has sent us shows that there was actually an increase in MAS5's own cost of funds at that time. It's now offered to re-work Mr and Mrs N's mortgage account from 12 September 2016 (up until November 2022) as if those increases never took place. So I won't consider this point any further, as the offer puts Mr and Mrs N back in the position they would have been in had the increases not been made (for the time period that is in scope of this complaint).

Should the redress go beyond November 2022?

MAS5 has offered to re-work Mr and Mrs N's mortgage account as though the interest rate they've been charged since 12 September 2016 was 1.25% lower than it was to reverse the effect of the 2011 and 2012 increases – but only up until the end of November 2022. It's said this is because it made the decision in 2022 not to pass on the full Bank of England base rate rises to customers when it could have done. That resulted in the SVR being 1.38% lower than it would have been had it passed on the full extent of the increases. MAS5 said if the SVR had in fact been 1.25% lower than it was before 2022, It would have taken the decision to pass on all of the base rate rises when they took place in 2022. This would have ensured that the SVR was priced at an appropriate level for its risk profile and market position. Therefore, the rate would have ended up 0.12% higher than it actually was in December 2022.

MAS5 has provided our service with evidence to support its arguments, including the factors the wider banking group considered when they were deciding whether to pass on the base rate rises to customers in 2022. It's clear the priorities for the banking group were to balance increases to the SVR to reflect increases to cost of funds with keeping down increases to maintain their market position, and to minimise customer stress. While that wasn't the case specifically for Mr and Mrs N's mortgage – since there's no evidence of a change in the costs of funding MAS5 itself at this time, the position of the MAS5 SVR comparative to the SVR charged to 'prime' customers in the group was also a key factor.

If the MAS5 SVR had been 1.25% lower than it actually was, it would have been lower than the SVR charged by other lenders within the group, as well as other lenders in the wider prime mortgage market.

Having considered the evidence MAS5 has provided, I'm satisfied that on balance, if the SVR had been 1.25% lower than it was at the start of 2022, MAS5 would have increased the SVR by more than it did during 2022, by passing on all of the base rate rises. That would have been permitted under the terms and conditions of Mr and Mrs N's mortgage.

However, whilst I'm persuaded that's what MAS5 would have done, I still have to consider whether that would have been fair and reasonable in order to determine whether the offer MAS5 has made is a fair resolution to this complaint. It's important to remember it is not the role of our service to decide what a fair interest rate should be. However, I can determine whether I think MAS5 has acted fairly when considering how to vary the rate it's charged Mr and Mrs N, and the impact that's had on them.

MAS5 has provided evidence of the risk profile of the mortgages it holds in comparison with the banking group's 'prime' mortgages. I'm satisfied that information shows that there is a greater cost to the group when a MAS5 mortgage defaults, and there is also a much higher risk of those mortgages defaulting. I don't think it's unreasonable that MAS5 considered that risk when deciding where its SVR should sit not only in relation to the 'prime' SVR charged by other lenders in the group, but also the wider mortgage market. I'm satisfied that had the SVR been 1.25% lower than it was, and MAS5 had not decided to pass on the base rate rises in 2022, the resulting SVR would have been significantly lower than not only the group's 'prime' SVR, but also the SVRs charged by mainstream lenders in the wider market.

Under the terms and conditions of Mr and Mrs N's mortgage MAS5 was entitled to increase the SVR to reflect changes in base rate. It's more likely than not, in my view, that if the SVR had been 1.25% lower because the 2011 and 2012 increases had not happened, MAS5 would have passed on the base rate changes in 2022 to move the SVR to a level comparable with other lenders in the group. Therefore, from November 2022, the SVR ended up at broadly the same level it would have been even without the 2011 and 2012 increases.

When considering the SVR Mr and Mrs N have been charged since 12 September 2016 in the round, and the impact of the previous unfair increases that resulted in that rate, I'm persuaded on balance that any previous unfairness was essentially 'put right' by the decisions MAS5 made when it varied the rate in the way that it did in 2022. And so, to instruct MAS5 to make an ongoing reduction to Mr and Mrs N's interest rate when that rate would be much lower than the rate they would actually have been on had MAS5 not done anything wrong, would be putting them in a better position than they ought to have been. To continue the redress beyond November 2022 means that Mr and Mrs N would benefit both from the SVR being lower because of the removal of the ongoing effect of the 2011 and 2012 increases, and also benefit from the SVR being lower because of the decision not to pass on base rate cuts. I don't think it's likely Mr and Mrs N's mortgage would ever have been in a situation where both those things happened, and therefore to require MAS5 to reduce their interest rate as if both had happened would be over-compensation. I know Mr and Mrs N discussed re-mortgaging within the banking group in 2020. If this is something they'd still like to explore, I'd encourage them to discuss their options with MAS5 to see if there are lower rates they might be able to benefit from by re-mortgaging to another lender within the group – or to take independent financial advice about moving their mortgage elsewhere.

Putting things right

MAS5 has offered to re-work Mr and Mrs N's mortgage account by reducing the rate on the mortgage by:

- 1.25% from 12 September 2016 to 30 August 2022;
- 0.75% from 1 September 2022 to 31 October 2022;
- 0.25% from 1 November 2022 to 30 November 2022.

The gradual change in the rate is a result of the timings of the changes MAS5 said it would have made had the rate been 1.25% lower before 2022. This reflects the fact that base rate increased by 0.5% in August and September 2022 – neither of which were passed on but would have been had the rate been lower.

As I've explained, I'm satisfied that this is what MAS5 would have done, had it not been charging Mr and Mrs N an unfairly high rate prior to 2022. And so I'm satisfied the offer it's now made puts Mr and Mrs N back in the position they would have been in, had MAS5 applied a fair rate of interest from 12 September 2016 onwards.

MAS5 should re-calculate the mortgage using the payments Mr and Mrs N actually made, but with revised monthly payments using the lower interest rate. I'm aware there have been arrears on this mortgage historically, and so this will result in changes to the arrears balance from time to time, and so MAS5 should also amend their credit files to reflect the revised position.

Any overpayments each month should be used to reduce the arrears balance at that time, and if there was no arrears balance carried forward. If there are any overpayments left after repaying the arrears, Mr and Mrs N should be given the choice of either having those repayments refunded to them, with simple annual interest of 8% running from the date of each payment to date of refund*; or having the overpayments treated as periodic overpayments to reduce the mortgage balance.

MAS5 will also need to refund any fees that had been added to the mortgage because of the arrears if the above re-work results in periods where arrears wouldn't have accrued.

I'm also satisfied that based on Mr and Mrs N's circumstances, MAS5 charging a higher rate than it should have done would have caused Mr and Mrs N distress and inconvenience. They experienced health problems and had difficulties affording their monthly payments at times and I think the fact those payments were higher than they ought to have been would have caused them distress. As a result, I'm satisfied MAS5 should pay Mr and Mrs N £500 for the distress and inconvenience caused.

*Interest is at the rate of 8% a year simple. If MAS5 considers that it's required by HM Revenue & Customs to take off income tax from that interest, it should tell Mr and Mrs N how much it's taken off. It should also give them a certificate showing this if they ask for one, so they can reclaim the tax from HM Revenue & Customs if appropriate.

My final decision

Considering everything, for the reasons I've explained, I uphold this complaint and instruct Mortgage Agency Services Number Five Limited (MAS5) to put things right as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr N and Mrs N to accept or reject my decision before 2 October 2024.

Kathryn Billings
Ombudsman