DRN-5199402

The complaint

Mr P and Mrs P disagree with the method used by Lloyds Bank PLC trading as Scottish Widows Bank to calculate interest on their offset mortgage account. They're also unhappy that Scottish Widows stores any unused offset benefit in a non-interest bearing account and doesn't provide them with updates as to the balance stored.

What happened

In December 2017, Mr P and Mrs P took out an offset mortgage with Scottish Widows. The mortgage was initially on a five-year fixed interest rate but reverted to the standard variable rate (SVR) at the end of February 2023.

Mr P has said that in anticipation of the mortgage reverting to the SVR, he started to make deposits to ensure the mortgage was fully offset by the time the fixed rate expired. So, he was surprised to then see a direct debit for over £2,600 leave his account in April 2023.

Upon enquiry, Mr P was told that the reason for the large increase was due to the mortgage changing to the SVR on 1 March 2023 whereas the offset savings benefit was based on the old fixed interest rate as the offset benefit is always one month behind the mortgage payment.

Dissatisfied with Scottish Widow's explanation, Mr P enquired again and raised concerns with how the offset account was operating. In response, he was informed that the offset benefit earned each month from savings in the offset saver account is used to reduce the interest element of the mortgage payment for the following month. But, because the mortgage is collected one month in arrears, the offset benefit accrued in one month will be used to reduce the mortgage payment two calendar months later.

Mr P and Mrs P consider this to be contrary to the normal understanding of how an offset mortgage account should work. They instead believe that a true offset account would mean interest would be charged on the net balance each month and there would not be the time lag as described above.

During Mr P and Mrs P's interactions with Scottish Widows it became apparent in July 2023, that they had an accrued offset balance of just over £4,700. And that they were told this would be refunded to them if they were to redeem the mortgage that day, but that no refund of the amount would be made while the mortgage was still live. Scottish Widows also confirmed it was unable to provide statements to keep Mr P and Mrs P informed of any unused accrued offset balance which is stored remotely. But that if they wanted to, they could call up and would be told the amount that was present in the month they were calling.

Unhappy with Scottish Widows' explanations and responses to their complaint, Mr P and Mrs P referred their complaint to our Service.

I issued a provisional decision on the complaint in November 2024. In summary I said:

- While Mr P and Mrs P ensured their mortgage was fully offset in the month that it was due to switch to the SVR, it was not offset early enough to account for the rise in the interest rate and this is why a direct debit of around £2,600 was taken from their account. The offset benefit a consumer earns each month from their offset savers account is used to reduce the interest element of their mortgage payment for the following month. And as the mortgage payment is collected one month in arrears, this means the savings benefit accrued in month one will go on to reduce the mortgage payment taken two calendar months later. In light of this, I did not intend to uphold this element of the complaint.

- While Mr P and Mrs P want Scottish Widows to accept that its offset account differs from the norm and that its marketing is misleading, my role is to determine individual complaints. It is not within my remit to direct Scottish Widows on how it structures and operates its accounts more widely or direct that it make a general statement about its accounts.

- I intended to find that Scottish Widows' literature about unused accrued offset benefit was limited and unclear such that it did not support a consumer's understanding of how and why this may arise and what would happen to those funds should this happen. I also thought it was unfair that Scottish Widows could store this unused accrued offset benefit remotely without notifying the consumer of the status of the account. So, I set out that I intended to direct Scottish Widows to proactively notify Mr P and Mrs P should this occur again in the future, without the need for them to call first.

- I also set out that, should Mr P and Mrs P wish to receive a refund of the unused accrued offset benefit identified in January 2024, Scottish Widows should facilitate this.

Mr P and Mrs P responded to my complaint. In essence they said:

- It would be misleading for my decision to be published in its provisional form without the acknowledgment that up to one month's deposit interest can be withheld by Scottish Widows until maturity.

- Scottish Widows had confirmed to Mr P that as of 26 November 2024, he would have been entitled to a refund of just over £3,400 in accrued offset benefit had the mortgage been redeemed that day. Which Mr P and Mrs P consider to be consistent with the lag in deposit interest and they believe this confirms that a refund arises on redemption when the mortgage is already offset, which is their principal concern.

- They do not wish to have a refund of the £88.50 available in January 2024.

- They say that the way Scottish Widows charges and credits interest on its offset mortgage accounts makes it impossible for customers to know where they stand as regards to redemption and results in consumers making an interest free loan to Scottish Widows.

Scottish Widows also responded to my provisional decision. In summary it said:

- Due to the nature of how its systems work, customers always accrue a stored offset benefit each month. And it should be noted that offset benefit is calculated daily based on the balance in the savings account. So, it would not be feasible to inform a consumer each time that the stored offset benefit changes as this would be a daily communication and likely inaccurate if the savings balance were to fluctuate.

- If Mr P and Mrs P would like to know how much offset benefit has accrued on their account at a specific point in time, they can contact Scottish Widows for this information.

- Stored offset benefit is effectively a pending interest reduction that will impact the mortgage in the future. If any stored offset benefit had been returned to Mr P and Mrs P, then this would not be offset against future interest and payments on the mortgage account, leading to higher payments. If there is no stored offset benefit available, then the account is not going to function as an offset mortgage.

- There is no provision in the terms and conditions that a saving of interest on the mortgage can be drawn down from the account. And allowing consumers to draw down the stored offset benefit would mean that customers are earning interest on their savings rather than accruing a saving of interest charged to their mortgage.

As both parties have now responded to my provisional conclusions, it is now appropriate for me to issue my 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.

Although I have read and reviewed the whole file, including the most recent submissions, I'll keep my comments to what I think is relevant. If I don't comment on any specific point, it is not because I've not considered it but because I don't think I need to comment on it in order to reach the right outcome.

Mr P and Mrs P's original complaint initially arose due to the amount of the direct debit taken in April 2023 which they say was unexpected as they had ensured that the account was fully offset before their account was due to switch to the SVR on 1 March 2023.

I set out in my provisional decision that I had reviewed the transaction history of the account alongside the terms and conditions of the mortgage. Having done so, I was satisfied Scottish Widows had operated the account correctly and that the sum of the direct debit taken was accurate. I highlighted that while Mr P and Mrs P had fully funded their account in February 2023, they would always have incurred this higher direct debit due to the way the account works.

In summary, the benefit accrued from the savers account is used to reduce the mortgage payment two calendar months later rather than the next month.

Neither party provided any further comments on this specific part of my provisional decision so in light of this and having reconsidered this complaint in full, I see no reason to depart from my provisional conclusion on this point. So, it follows that I do not uphold this element of Mr P and Mrs P's complaint and I find that Scottish Widows operated the account fairly and in line with its terms and conditions on this point.

Mr P and Mrs P accept my provisional conclusion that it is not within my remit to direct Scottish Widows to alter how it charges and credits interest on this account or to make general statements about the offset account. But they think it would be misleading if my decision were to be published without acknowledging that up to a month's deposit interest could be withheld from the consumer until maturity.

Mr P spoke to Scottish Widows last month and was told that he would be entitled to a refund of just over £3,400 if the mortgage were to be redeemed. Mr P and Mrs P consider this to be consistent with their concern that a refund arises on redemption and that they are essentially providing Scottish Widows with a nine-year interest free loan.

It will likely always be the case that if a consumer were to redeem their offset mortgage mid-term, having previously ensured that it was fully offset, that they would be entitled to a refund of any offset benefit that had accrued in the preceding month.

For an offset mortgage to operate as intended, there will always be a lag between the offset benefit accrued and the application of that benefit to the mortgage payment, so should a mortgage be redeemed before that payment is taken, a refund will fall due. This is the account operating as it should and I do not agree with Mr P and Mrs P's comments that the operation of the account in this way means they are effectively granting Scottish Widows an interest free loan until the end of their mortgage term. For the most part, any accrued offset benefit is applied to the mortgage the following month and is used to reduce the interest element of the mortgage payment due to be taken in two calendar months' time – not stored until the end of the agreed mortgage term.

As I set out in my provisional decision, I believe the confusion arises here because of the similarity of the terms used by Scottish Widows to describe both accrued offset benefit and unused/surplus accrued offset benefit. An accrual of offset benefit each month which is stored and then applied to the mortgage account in the following month is what I would expect to see and is the account operating as it should.

I do, however, agree that Scottish Widows' use of '*unused* accrued offset benefit' or 'surplus offset benefit' is not clearly explained in the product literature and has led to confusion in this case as to the status of the mortgage account and how Mr P and Mrs P's funds are being stored and used.

In Mr P and Mrs P's case, there have been months where the amount of accrued offset benefit have exceeded the amount needed to clear their full mortgage repayment. This has led to a surplus of offset benefit which has been stored remotely by Scottish Widows for use against future mortgage repayments.

This surplus offset benefit is not visible to Mr P and Mrs P through the normal reporting of the account by Scottish Widows. And unless they call and ask about whether they have any unused or surplus offset benefit, they will not be notified of it.

I set out in my provisional decision that I thought it was unfair that Scottish Widows stores these funds without Mr P and Mrs P's knowledge. I remain of the opinion that doing so prevents Mr P and Mrs P from being able to properly understand the status of their offset mortgage account or how best to use their money. As it stands, Mr P and Mrs P are unaware in any given month whether they have any unused/surplus offset benefit and therefore how much they need or may want to put in their offset saver account versus spend or invest elsewhere.

In response to my provisional decision Scottish Widows has gone to some length to explain that accrued offset benefit is calculated daily and therefore it would not be feasible to provide up to date and accurate information to Mr P and Mrs P as to how much accrued offset benefit they hold at any particular point in time. But this is not what I suggested it do in my provisional decision.

I set out in my provisional decision and above that there will always be a lag between the accrual of offset benefit and its application to the mortgage account. And as such, there will always be an amount of accrued offset benefit being held by Scottish Widows before it is applied to reduce the amount of interest Mr P and Mrs P need to pay toward their mortgage. This in and of itself is not a concern and I agree that to provide daily updates of said accrual would not be feasible.

However, the accrual of unused or surplus offset benefit is not a daily occurrence. This is something that may happen in any given month but not necessarily every month – as is the case for Mr P and Mrs P. And it is the lack of timely disclosure regarding this *unused* or *surplus* accrued offset benefit that I consider to be unfair and not clearly covered by the terms and conditions of the account or its wider literature.

Having considered the submissions from both parties, my decision remains the same on this point. Scottish Widows should take steps to proactively notify Mr P and Mrs P when unused/surplus benefit occurs so they may be better informed as to how to manage their offset account.

I am aware Scottish Widows has said its system limitations mean it is unable to send monthly statements sharing the amount of any stored offset benefit. However, as I set out in my provisional decision, given Scottish Widows' systems tell it how much unused/surplus benefit a consumer has at any one time, it is clear it does have access to this information. And I am not persuaded it has taken adequate steps to identify an alternate means of proactively sharing such information with Mr P and Mrs P without the need for them to call or write first. It is not for me to tell Scottish Widows to amend its systems, that is beyond my remit and not necessary in the circumstances of this complaint. Instead, Scottish Widows needs to take reasonable steps to find an alternate way to proactively notify Mr P and Mrs P as and when unused/surplus benefit accrues on their account.

Finally, in my provisional decision I set out that any remaining unused/surplus benefit be refunded to Mr P and Mrs P should they ask for it. In response, Mr P and Mrs P have said they do not want this to happen as the sum involved was too small. Given this, and that the surplus amount has now been used to reduce the interest due to their mortgage so no longer remains as unused benefit, I am not going to direct that Scottish Widows refund this amount on this occasion.

Putting things right

Scottish Widows should take reasonable steps to proactively notify Mr P and Mrs P should unused/surplus offset benefit accrue on their account in the future.

The method it does this in can be at the discretion of Scottish Widows as long as it provides Mr P and Mrs P with timely, clear, fair and not misleading information about their account.

My final decision

For the reasons set out above, I uphold this complaint in part and direct Lloyds Bank PLC trading as Scottish Widows Bank to put things right as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr P and Mrs P to accept or reject my decision before 14 January 2025.

Lucy Wilson
Ombudsman