

FINAL DECISION

Complainants:	Mr and Mrs G
Firm:	Abbey National plc
Complaint Reference:	1000067050/B/MI/BLT2 – DVR
Date of Final Decision:	4 September 2002

SUMMARY

Complaint

- 1 Mr and Mrs G had an Abbey National “*standard variable interest rate*” cashback mortgage, resulting from a mortgage offer dated 31 December 1996. They complained that:
 - It was unfair that Abbey National required them to repay the whole of their cashback if they redeemed their mortgage on or before 31 January 2003.
 - It was unfair that Abbey National had introduced new base mortgage rates from 25 April 2001 but continued to apply a higher rate to their mortgage loan.

Adjudicator’s findings

- 2 After investigating these complaints, the adjudicator came to the following conclusions:
 - The provisions in Mr and Mrs G’s mortgage requiring them to repay the cashback were not unfair and were enforceable.
 - From 25 April 2001, Mr and Mrs G should have been allowed to transfer to Abbey National’s basic *Classic* rate.
 - Abbey National should recalculate at the basic *Classic* rate, from 25 April 2001, that part of Mr and Mrs G’s mortgage which was on a variable rate;
 - Abbey National should refund any overpayment and also pay Mr and Mrs G £150 for the inconvenience they had been caused.

Review

- 3 As it was entitled to do, Abbey National asked for the adjudicator’s decision to be reviewed by an ombudsman. It said it had not previously understood the approach the adjudicator would take, and submitted extensive additional arguments.
- 4 In view of the quantity of new material submitted by Abbey National, I issued a provisional decision – to give both sides an opportunity of commenting, once they saw my approach, before I issued this final decision.
 - Mr and Mrs G said they agreed with my provisional decision.
 - Abbey National said it disagreed with my provisional decision, but would accept it.

- 5 There are many aspects of the adjudicator's decision that neither side had challenged. In particular, neither party had challenged the adjudicator's conclusions that:
- The provisions in Mr and Mrs G's mortgage requiring them to repay the cashback were not unfair and were enforceable.
 - Mr and Mrs G's mortgage provided for them to pay interest at Abbey National's "*standard variable interest rate*".
 - In relation to the variable-rate portion of Mr and Mrs G's mortgage, the position is not affected by their 2001 remortgage.
 - It makes no difference that mortgages branded *Abbey National* may be provided or administered by Abbey National Mortgage Finance plc.
- 6 That left one very significant remaining area of dispute for me to decide - the effect and consequences of the reference to Abbey National's "*standard variable interest rate*" in relation to Mr and Mrs G's mortgage after the introduction of the *Classic* rate.

Decision

- 7 For the reasons explained below, I consider that:
- Mr and Mrs G promised to repay the cashback if they did not keep their variable-rate mortgage with Abbey National until 31 January 2003. Abbey National promised that in all other respects it would treat them like ordinary variable-rate borrowers with no tie-in.
 - Ordinary variable-rate borrowers with no tie-in were allowed to transfer to the new and lower basic *Classic* rate – which was the no-frills rate offered to new borrowers. So Mr and Mrs G should have been allowed to transfer to the new lower rate without repaying the cashback.
 - Because the new lower rate was only available to ordinary variable-rate borrowers on application, Mr and Mrs G would not have been entitled to compensation for any period before they had applied for the new rate. But they had applied for it after it was announced and before it was introduced.
- 8 Accordingly:
- From 25 April 2001, Mr and Mrs G should have been allowed to transfer to Abbey National's basic *Classic* rate.
 - Abbey National should recalculate at the basic *Classic* rate, from 25 April 2001, that part of Mr and Mrs G's mortgages which were on a variable rate;
 - Abbey National should refund any overpayment and also pay Mr and Mrs G £150 for the inconvenience they had been caused.

REASONS

Abbey National's announcement of new rates

- 9 On 5 March 2001 Abbey National issued the following press release [the emboldening appears in the original; the underlining is mine]:

“Abbey National offers more choice for mortgage customers

“Daily interest for new business, choice of no-frills tracker, or fully flexible mortgage with internet access

“From 30 April 2001, people taking out a new Abbey National mortgage on a special introductory deal can choose whether their mortgage reverts to a no-frills tracker (at 0.9% over base rate) or a fully flexible mortgage (at 1.0% over base rate) after the special deal period has ended (1). All new mortgages will be calculated on a daily interest basis from the start.

“Abbey National has made this move to give customers clear options:

- “a) a no-frills, low cost tracker for people who want to keep payments to a minimum and don't need flexibility - at 6.65% (2)*
“b) a good value flexible option for the growing number of people who want full flexibility - at 6.75%

“Abbey National will continue to offer introductory rates for new mortgage customers, which will primarily be two and five year fixed-rate and discount mortgages. Customers will move to the new variable rates after the end of these introductory periods.

“The new variable rate mortgages will also be available from 30 April 2001 to all existing Abbey National mortgage customers who are not on special deals.” (3)

“Abbey National will contact all existing mortgage customers over the next 12 months to offer them a homeowner's review. This will involve discussing their mortgage and financial needs, and seeing if they would like to move to either the new tracker or new flexible mortgage deals.

“Abbey National was one of the first UK lenders to launch a flexible mortgage, in July 1999. Flexible mortgages now account for nearly one in five of all Abbey National's new mortgages, and have no tie-ins.

“From this summer, the flexible mortgage will be fully interactive through the internet. Customers will be able to manage their mortgage online anytime, anywhere and pay more, pay less, take a break or borrow more. Customers will be able to see how these flexible options will save them interest or reduce the life of their mortgage by using an interactive 'show me' facility.

*“**Andrew Pople, Managing Director of Retail Banking said:** ‘Our objective is to offer our customers more choice, not less. We will offer a range of mortgages that are in tune with customers' lifestyles as well as their bank balances. The future mortgage battleground will be fought on flexibility and value for money rather than just price alone.*

“Today's announcement stamps a definitive sell-by date on our present standard variable rate - good news for existing and new customers. I'm adamant that the launch of our new variable rates will provide us with the means to retain and reward all our

customers, helping to ensure that customers who come in through the front door on introductory deals do not want or need to slip quietly out of the back door months later.

‘I would say to any homeowner, if your mortgage lender can't provide you with a competitive rate, daily interest, no extended tie-ins, and a mortgage that allows you to overpay, underpay or take payment holidays, come and talk to us.’

“Ends

“Editors Notes

“1. New standard variable rates will be available from 30 April, 2001.

“2. The Bank of England base rate differentials of 0.9% for the tracker mortgage and 1.0% for the flexible mortgage are guaranteed until 1/1/2003.

“3. Existing customers on tied mortgage deals may have to pay the appropriate redemption charge if they choose to switch while in a period that has penalties for redeeming early.

“4. Abbey National plc, which is regulated by the Personal Investment Authority, only sells its own life assurance, pension and collective investment scheme products.

“5. Competitor table available.”

10 In the event:

- The new rates were introduced on 25 April 2001. The “no-frills tracker” was called “Classic”. The “fully flexible mortgage” was called “Lifestyle”.
- The rate Abbey National called its *Standard Variable Rate* from 25 April 2001 has always been higher than the basic *Classic* rate.

11 Abbey National’s booklet “*Choosing the right mortgage – a practical guide*” describes:

- the *Classic* range as “*Simple straightforward mortgages*”; and
- the *Lifestyle* range as “*Mortgages that put you in control*”.

12 The basic *Classic* interest rate is 0.1% lower than the basic *Lifestyle* rate. The main difference between the two ranges appears to be that the *Lifestyle* range is flexible. A *Lifestyle* borrower who is not restricted by the terms of any introductory or other offer can (unlike a *Classic* borrower) make lump-sum payments, underpayments or overpayments – and can take payment holidays.

Mr and Mrs G’s mortgages

13 Mr and Mrs G had taken out an Abbey National mortgage, resulting from a mortgage offer dated 31 December 1996:

- The loan was for £85,878.53.
- Interest was to be at Abbey National’s “*standard variable interest rate*”.
- There was a £4,225.00 ‘cashback’.

14 The cashback was a sum of money that Abbey National paid to Mr and Mrs G. They had to repay it to Abbey National if they redeemed the mortgage on or before 31 January 2003, unless they simultaneously took out a new loan for at least as much as the balance on the old loan and on the same interest rate.

- 15 Early in 2001 Mr and Mrs G wanted to move house and increase their mortgage.
- They complained to Abbey National. Initially they complained about the requirement to repay the cashback and asked to be able to choose the whole of their new mortgage from Abbey National's full range.
 - When the tracker rates were announced, and before these were introduced, Mr and Mrs G elaborated their complaint to say that the rate available to borrowers who were not tied-in should also have been available to them.
- 16 Abbey National would not let them take out the whole of their new mortgage on a tracker rate without repaying the cashback. So when Mr and Mrs G took out their new Abbey National mortgage, and to avoid repaying the cashback, they took £68,679 of it (equivalent to the outstanding balance on their old loan) on the original 1996 standard variable rate terms. They did so under protest and without prejudice to their complaint.
- 17 From 25 April 2001 Abbey National charged Mr and Mrs G according to a rate that it called its *Standard Variable Rate*. Mr and Mrs G complained that this meant they were being charged a "*penalty rate*".

1995 Mortgage Conditions

- 18 Mr and Mrs G's mortgages incorporated Abbey National's 1995 Mortgage Conditions.
- Paragraph 2.20 defines "*variable rate*" as a rate of interest that Abbey National can change under conditions 9.2 or 9.3 (including a rate which it can only change within limits set out in the mortgage offer).
 - But Paragraph 9.1 says that paragraph 9.3 does not apply during any "*fee period*", which is defined by paragraph 2.5 to include a period within which a cashback is repayable. So paragraph 9.3 will not apply in this case until after 31 January 2003.
- 19 Paragraph 9.2 says Abbey National can change the variable rate at any time for one or more of the following reasons:
- to maintain the competitiveness of its business as a whole, taking into account actual or expected changes in market conditions;
 - to reflect actual or expected changes in the cost of the funds it uses in its mortgage business;
 - to ensure its business is run prudently;
 - to reflect a change in the general practice of mortgage lenders;
 - to reflect any regulatory requirements or guidance or any change in the law or decision or recommendation by the court or an ombudsman; or
 - to reflect a change which it reasonably believes has occurred, or is likely to occur, in the risks it runs in connection with its security or the recovery of the money the borrower owes it.
- 20 Paragraph 9.6 says Abbey National will charge interest based on the balance at the beginning of the "*interest period*" – which is defined by paragraph 2.8 as a year, or any

other period Abbey National specifies as the interest period in the mortgage offer or under paragraph 9.5.

- 21 Paragraph 9.5 says Abbey National can change the interest period (between a maximum of a year and a minimum of a month) on three months' notice, for one or more of the following reasons:
- to match the period which is used to work out the costs it must meet for using the money it had lent the borrower under the mortgage;
 - to match the interest period it applies to new mortgages which are similar to the mortgage;
 - to reflect current banking practice;
 - to reflect current mortgage lending practice; or
 - to reflect developments in technology.

2001 Mortgage Conditions

- 22 The new tracker rates were provided in conjunction with Abbey National's 2001 Mortgage Conditions. These define:
- "*tracking rate*" as the "*base rate plus or minus the tracking differential*";
 - "*base rate*" as Bank of England repo rate [a rate which is outside Abbey National's control]; and
 - "*tracking differential*" as the percentage which Abbey National adds to or subtracts from the "*base rate*" to arrive at the "*tracking rate*".
- 23 The Conditions say that Abbey National can change the "*tracking differential*" at any time. No list of reasons is specified – so the change can be for any reason. But:
- Abbey National has to give written notice of the change – of 30 days in the case of an increase or 7 days in the case of a reduction.
 - If the differential is increased, borrowers subject to a "*product-related charge*" (such as a requirement to repay a cashback) can redeem their mortgage within three months without having to pay the charge.
- 24 The 2001 Mortgage Conditions also say, in effect, that:
- interest will be added to capital monthly, if not paid off in the meantime; and
 - payments by the borrower will reduce the capital daily.

Interest Rates

- 25 The basic *Classic* rate is the rate that has applied to new no-frills mortgages since 25 April 2001, and the rate to which new special deals (other than those on flexible *Lifestyle* terms) revert at the end of any special interest rate period.
- 26 The following tables shows for the period from January 2000:
- 'BofE': Bank of England repo rate (sometimes called base rate)
 - 'Classic': the basic *Classic* rate

- ‘SVR’: the rate Abbey National called its *Standard Variable Rate*
- ‘SVR/BofE’: the amount by which the ‘SVR’ exceeded ‘BofE’
- ‘SVR/Classic’: the amount by which ‘SVR’ exceeded ‘Classic’

From 1 January 2000 to the introduction of Classic on 25 April 2001					
From date	B of E	Classic	SVR	SVR/B of E	SVR/Classic
1 January 2000	5.50%		[note 1] 7.19%	1.69%	
13 January 2000	5.75%				
1 February 2000			7.44%	1.69%	
10 February 2000	6.00				
[note 2] 1 March 2000			7.74%	1.74%	
8 February 2001	5.75%				
1 March 2001			7.49%	1.74%	
5 April 2001	5.50%				

From the introduction of Classic on 25 April 2001 to date					
From date	B of E	Classic	SVR	SVR/B of E	SVR/Classic
25 April 2001		6.40%			
1 May 2001			7.25%	1.75%	0.85%
10 May 2001	5.25%				
1 June 2001			7.00%	1.75%	
[note 3] 3 June 2001		6.15%			0.85%
2 August 2001	5.00%				
1 September 2001			6.75%	1.75%	
3 September 2001		5.90%			0.85%
18 September 2001	4.75%				
1 October 2001			6.65%	1.90%	
3 October 2001		5.65%			1.00%
4 October 2001	4.50%				
1 November 2001			6.50%	2.00%	
3 November 2001		5.40%			1.10%
8 November 2001	4.00%				
1 December 2001			6.10%	2.10%	
3 December 2001		4.90%			1.20%

Notes:

¹ On loans of £60,000 to £99,999

² Date of change not on Firm’s website

³ Under Condition 2.6 the ‘base rate period’ begins on 3rd of the month

27 I note:

- From January 2001 to April 2001 the amount by which the rate Abbey National called its *Standard Variable Rate* exceeded Bank of England repo rate increased marginally, by 0.05% (from 1.69% to 1.74%).
- From then until December 2001 the amount by which the rate Abbey National called its *Standard Variable Rate* exceeded Bank of England repo rate increased more substantially, by 0.36% (from 1.74% to 2.10%).
- In a letter of 3 September 2001 Abbey National said that the rate it called its *Standard Variable Rate* had been reduced in line with the basic *Classic* rate. That was correct at that time.

- But, after that, Abbey National increased the amount by which the rate it called its *Standard Variable Rate* exceeded the basic *Classic* rate. By December 2000 the differential had increased by 0.35% (from 0.85% to 1.20%).

Legal Principles of Interpretation

- 28 I am required to reach my decision on the basis of what I consider to be fair in all the circumstances of the case. But I have taken into account the legal principles of interpretation.
- 29 It is a general principle of English law that an ambiguous contractual term must be given the interpretation that is less favourable to the party who supplied the wording. Abbey National supplied the wording of the mortgage contract.
- 30 The House of Lords (acting as ultimate appeal court) considered the principles for interpreting contracts in the case of *Investors Compensation Scheme Ltd v West Bromwich Building Society and others*.
- 31 That case is reported in volume 1 of the Weekly Law Reports for 1998, starting at page 896. A passage from the judgement of Lord Hoffman at pages 912 and 913 contains a helpful summary of principles. The gist is:
- The law disregards what the parties said they intended to do, and what they said in prior negotiations. Parties can change their position during the negotiation process.
 - Apart from this, the law avoids a technical approach. It follows the common-sense principles that would be applied to any serious utterance in ordinary life.
 - The aim is to decide what the contract would have meant to a reasonable person who had all the background knowledge reasonably available to the parties at the time of the contract.
 - That background knowledge includes anything that would have affected the way in which a reasonable man would have understood the language of the document.
 - The meaning of a document is not the same as the dictionary meaning of its words. It is what those words would be understood to mean in the circumstances.
 - The circumstances can help choose between possible meanings where words are ambiguous, or may even show that the parties used the wrong words or syntax.

Unfair Terms in Consumer Contracts Regulations

- 32 Mr and Mrs G's mortgage is covered by the Unfair Terms in Consumer Contracts Regulations.
- The 1994 Regulations have been replaced by the 1999 Regulations, but without any changes of substance that are material to this case.
 - The Regulations require an unclear contractual term to be given the interpretation that is most favourable to the consumer. Mr and Mrs G were the consumers.
 - The fairness of any term must be considered in the light of the circumstances that obtained when the contract was entered into, not with the benefit of hindsight.

- 33 Schedule 2 of the Regulations contains indicative provisions that are relevant to mortgage lenders in connection with interest-rate-variation clauses, such as those in Abbey National's 1995 and 2001 Mortgage Conditions:
- Paragraph 1(j) indicates that contract terms which enable the lender to alter the terms of the mortgage contract unilaterally without a valid reason *specified in the contract* may be unfair.
 - Paragraph 2(b) indicates that, despite paragraph 1(j), contract terms that allow the lender to alter the interest rate for a valid reason *not specified in the contract* may not be unfair *if* the contract provides that:
 - the lender will inform the borrower at the earliest opportunity; and
 - the borrower will then be free to redeem the mortgage immediately.
 - Paragraph 2(c) indicates that, despite paragraph 1(j), contract terms that link the interest rate to an external index or rate that the lender does not control are likely to be fair.
- 34 *Wurtzburg and Mills - Building Society Law* (whose editors include Malcolm Waters QC) deals, at paragraphs 6/30-6/31, with the impact of the Regulations on a mortgage-interest-rate variation term linked to a lender's across-the-board standard variable rate. It says:

"Such a term will prevent the lender from taking an unfair advantage of the captive status of its 'locked in' borrowers by imposing on them a rate change which it is not also prepared to impose on its new and non-captive borrowers."

Office of Fair Trading Guidance

- 35 In February 2000 the Office of Fair Trading issued a "guidance note for mortgage lenders and deposit-takers on what the OFT considers to be fair terms and unfair terms for interest variation in mortgage and savings products contracts". It said that the "guidance does not address all possible concerns that might arise about savings and mortgage products generally".
- 36 The guidance was issued after Mr and Mrs G had taken out their mortgage. But it comprised the Office of Fair Trading's view on the already-existing position under the Unfair Terms in Consumer Contracts Regulations.
- 37 The guidance focused on cases where consumers were tied in, for example by a requirement to pay an early repayment charge on a mortgage. Amongst other things, it said:

"A term reserving the right to vary an interest rate for stated reasons does not satisfy the requirement of the Regulations unless it is drafted so that it cannot permit the rate to be moved in such a way as to leave 'locked in' consumers in a less advantageous position than new customers or those who are free to move accounts. Where consumers are locked in and the lender requires a right to vary rates, various approaches can be taken to limit the scope for consumer detriment, and help to ensure compliance with the Regulations." [my underlining]

38 It went on to give examples of such approaches. But it said that:

“fairness cannot be guaranteed solely by modelling a term on one of these examples since the fairness of the whole transaction needs to be taken into account when assessing the fairness of any particular term.”

39 The example approaches included: changes that are agreed in advance; changes that are applicable across the board; an explicit link to an external rate, or index, or openly marketed rate; or a floor or cap with reference to an external rate, or index or openly marketed rate. Changes that are applicable across the board are ones where, amongst other things, they apply to consumers who are not tied in.

Jurisdiction

40 Mr and Mrs G made their complaint about Abbey National to the former Banking Ombudsman Scheme. Under The Financial Services and Markets Act 2000 (Transitional Provisions) (Ombudsman Scheme and Complaints Scheme) Order 2001 (“the Order”):

- The complaint is to be determined by the Financial Ombudsman Service as a *“relevant existing complaint”*.
- A relevant existing complaint is to be determined by reference to such criteria as would have applied under the former scheme.

41 The rules of the Banking Ombudsman Scheme did not allow consideration of complaints about a bank’s general interest rate policies. So I cannot consider the fairness of introducing the new tracker rates. But I can consider how Abbey National treated Mr and Mrs G in the light of the terms it had agreed with them.

Abbey National’s arguments

42 Abbey National put forward its arguments at length. I have carefully considered all of the points it made. The following is only a summary.

43 Abbey National said, about the history of its *“standard variable interest rate”*:

- There had been a time when a majority of borrowers applied for no-frills standard variable rate mortgages. At that time, the standard variable rate could have been considered as a product in its own right.
- But the standard variable rate had long since ceased to be a product by the time Mr and Mrs G applied for their mortgage in 1996. By then it would have been regarded, both by Abbey National and its borrowers, as a rate which was simply:
 - a reference rate from which introductory discounted variable rates were to be calculated;
 - a higher than normal introductory rate for those borrowers who received some other benefit (such as a cashback); and
 - a reversionary rate which would apply after an introductory discounted or fixed rate deal had come to an end.

- The standard variable rate was not a headline product used to entice new borrowers or retain existing borrowers, and was not competitive when compared against discounted or fixed rate products.
 - Customers seeking a competitive mortgage did not complete on the standard variable rate, as they would know that cheaper packages were available. Since 1996 less than 5% of borrowers actually applied for this rate without any additional benefit.
- 44 Abbey National said, about its approach to the introduction of new interest rates in 2001:
- Its position was not the same as some other lenders about whom complaints had been considered by the Financial Ombudsman Service, because it had never published more than one standard variable rate and it had never had more than one rate that possessed the characteristics of such a rate.
 - The names it gave its rates reflected what they actually were. Its standard variable rate was a rate that was variable by Abbey National. Its tracker rates tracked Bank of England repo rate (which was sometimes called Bank of England base rate) and none of them could be fairly described as a standard variable rate.
 - The standard variable rate was a benchmark rate used to set the rate on a variety of variable-rate products. By contrast, the *Classic* tracker was not a rate – it was a product.
 - There was no guarantee that the *Classic* rates would always be less than the standard variable rate. The opposite might be the case at times. So it would not necessarily benefit standard variable customers if Abbey National were to switch them to the basic *Classic* rate – even if it had the power to do so, which it did not.
- 45 Abbey National said, about its press release of 5 March 2001:
- The press release was not well phrased in referring to the tracker rates as “*the new variable rates*” and to the tracker rate mortgages as “*the new variable rate mortgages*”. Abbey National regretted that this was misleading.
 - The reference to “*a definitive sell-by date on Abbey National’s present standard variable rate*” was clearly directed primarily at mortgages on offer to new customers. The benefit to existing customers was the possibility of switching, as a result of the homeowner’s review programme. But this was secondary.
 - The “*Editor’s Notes*” were added late. Their reference to “*new standard variable rates*” was both unfortunate and inaccurate. But they would not have been published and so were not ‘reasonably available’ for the purpose of the test in *Investors Compensation Scheme v West Bromwich Building Society and others*.
 - In any event, a press release could not alter the terms of Mr and Mrs G’s mortgage contract. And the press release did state clearly that the new rates would not be available to customers on special deals, which included those with a cashback (like Mr and Mrs G).
- 46 Abbey National said, about the variable rate it charged Mr and Mrs G from 25 April 2001:

- The rate it had charged Mr and Mrs G was the only rate it had published as its standard variable rate. It was the only rate that possessed the essential characteristic of a standard variable rate – namely that it was a rate the lender was free to alter.
- Mr and Mrs G’s mortgages incorporated Abbey National’s 1995 Mortgage Conditions – under which a “*variable rate*” was one:
 - Abbey National could change for valid reasons;
 - at any time without prior notice;
 - even to reflect predicted future circumstances, such as the future cost of funds.

47 Abbey National said, about its tracker rates introduced from 25 April 2001:

- The basic *Classic* rate had never been published as Abbey National’s standard variable rate. It did not function in the same way as a standard variable rate, because it changed automatically to reflect changes in Bank of England repo rate.
- The 2001 Mortgage Conditions applicable to the *Classic* rate provided for it to:
 - vary automatically in line with Bank of England repo rate;
 - on the third day of the month;
 - thereby reflecting only past circumstances.
- It was true that Abbey National could alter the *Classic* rate by changing the “*tracking differential*” between the *Classic* rate and Bank of England repo rate. But increasing the rate in this way was subject to onerous obligations – thirty days’ prior notice by personal notification to borrowers, who then had three months in which they could redeem free from any early repayment charge.
- Because of commercial constraints, the practical consequences were that the tracking differential would not be changed except in exceptional circumstances. This was to be contrasted with the absence of such onerous obligations in the case of the standard variable rate.
- Furthermore, the basic *Classic* rate could not be a standard variable interest rate because Abbey National had promised that – until 1 January 2003 – the rate would not exceed Bank of England repo rate by more than 0.9%.

48 Abbey National said, about the interpretation of Mr and Mrs G’s mortgage:

- The adjudication turned on a pure point of law – namely the correct construction of Mr and Mrs G’s contractual obligation to pay interest at Abbey National’s standard variable rate.
- Applying the test in *Investors Compensation Scheme Ltd v West Bromwich Building Society and others* - a reasonable person with all the background knowledge reasonably available to the parties at the time of the contract would not have concluded that Mr and Mrs G’s mortgage contract would be affected by the subsequent introduction of a rate which:
 - had a different name;
 - was set and calculated in a different way; and
 - was governed by different conditions.
- Mr and Mrs G themselves understood this. They challenged the requirement to pay the cashback and alleged that the standard variable rate was a penal rate. But

they did not claim they had been misled into thinking that the basic *Classic* rate was the standard variable rate – as witness the last paragraph on page 2 of their letter of 14 March 2001.

- It had correctly carried out the terms of Mr and Mrs G's mortgage contract, by charging them its standard variable rate. Their mortgage contract did not require Abbey National to switch them to the basic *Classic* rate.

49 Abbey National said, about the effect of its Mortgage Conditions on the interpretation of Mr and Mrs G's mortgage:

- The 1995 Mortgage Conditions (to which Mr and Mrs G's mortgages were subject) specified the ways in which Abbey National could alter the interest rate. These were entirely inconsistent with the way the interest rate changed automatically under the 2001 Mortgage Conditions applicable to the *Classic* rate.
- Under the 1995 Mortgage Conditions: interest is calculated with yearly rests, and payments do not affect the balance on which interest is charged until the beginning of the following year. By contrast, under the 2001 Mortgage Conditions: interest is calculated with monthly rests, and payments affect the balance on which interest is charged on the day they are made.
- A change from yearly rests to monthly rests would not necessarily be in the interests of all borrowers. An annual review (under which the monthly payment was changed only once a year, even if there were numerous interest-rate changes) was not available on the mortgage system used for the tracker mortgages.
- So a change to the basic *Classic* rate, and from interest calculated yearly to interest calculated monthly, would involve a variation of Mr and Mrs G's contract. This demonstrated that they were not automatically entitled to the basic *Classic* rate.
- Even if (which it did not accept) Mr and Mrs G were entitled to have the basic *Classic* rate made available to them on signing an appropriate variation of their contract, this could not have run from 25 April 2001 – because they did not complete their new mortgage until 14 June 2001.

50 Abbey National said, about the cashback:

- The standard variable rate was the 'price' the Gs agreed to pay for choosing to have a cashback. It was not a rate they would otherwise have chosen for their mortgage in its own right.
- The existence of the tie-in period during which Mr and Mrs G were required to pay the standard variable rate demonstrated that it did not compare favourably with other rates – or there would have been no need for the tie-in.
- So it would be clear to any reasonable person that Mr and Mrs G were intended to be tied into paying a higher rate than variable-rate borrowers who did not obtain a cashback.
- In the case of *Wright v Abbey National* (Kingston-upon-Thames County Court number KT905412 on 11 September 2000) the District Judge accepted the fairness of a requirement for the borrower to pay the standard variable rate long enough for Abbey National to recoup the loss caused by a low initial fixed rate.

- It was equally fair that Mr and Mrs G should be required to pay the standard variable rate long enough for Abbey National to recoup the loss caused by the cashback.
 - If any comparison were made between the standard variable rate and the rates charged for products in the *Classic* range, the comparison should be with the cashback *Classic* rate, which was 0.85% higher than the basic *Classic* rate.
- 51 Abbey National said, about the potentially wider consequences of the adjudicator's decision:
- Mr and Mrs G's cashback product was costed on a specific rate. It involved a small loss over the period to 31 January 2003, which Abbey National was prepared to accept – in return for the benefit of acquiring a customer relationship that might well continue longer, and the opportunity to sell other products.
 - It would not be fair and reasonable to require Abbey National to charge a lower rate from 25 April 2001. This would result in its loss over the period to 31 January 2003 more than doubling. Bearing in mind the number of borrowers with similar mortgages, that would have far-reaching financial implications.
 - The adjudication had the potential to restrict customer choice by obliging Abbey National to withdraw alternative pricing mechanisms and use one reference rate for all product pricing.
- 52 Abbey National was asked whether or not it accepted Mr and Mrs G's contention that they were paying a rate different from that paid by borrowers who were not tied in. Its response said:
- “A great many customers pay the standard variable rate, not just those that are contractually obliged to do so by virtue of having benefited from a fixed/capped/discount rate or a cashback mortgage. Of the total number of customers who pay the SVR, approximately just 12% of them are ‘tied’ to paying it as a result of their contractual obligations.”*
- 53 Abbey National was asked to identify the commercial constraints which restricted its ability to change the standard variable rate in 1996 (when it made the relevant mortgage offer to Mr and Mrs G) and now. Its response said:
- There was in 1996, and there is now, no specified differential between the standard variable rate and Bank of England repo rate. So the rate was in 1996, and is now, managed by Abbey National - subject to the legal constraint that any change must be for valid reasons in accordance with the 1995 Mortgage Conditions.
 - *“Standard Variable Rate remains a rate commonly paid by customers both internally and in the mortgage market. The mortgage market is extremely competitive, information is widely available and it is very easy for borrowers to move between lenders.”*
 - *“Retention of existing customers is as key to a lenders (sic) success, as recruiting new business, it is essential to ensure that the Standard Variable rate remains competitive as well as new business upfront deals. Standard Variable Rate is a managed rate, but the amount by which it can be changed will be subject to the commercial constraint of remaining competitive.”*

- “New business deals were linked to Standard Variable Rate in 1996, this is no longer the case today, however the commercial constraints of the link to Standard Variable Rate for new business is (sic) very limited. New customers are not purchasing Standard Variable rate but the net rate on the up front deal.”
- “When SVR rates are changed the level of discounts for new business can also be changed to ensure the net rate payable on the upfront deal remains the same. Therefore, changing Standard Variable rate will have little or no impact on new business, this was the case both in 1996 and today. ...”
- “The commercial and legal constraints on Standard Variable Rate are unchanged from when the Gs took out their mortgage in 1996 and today, if anything the market has become more competitive and the need to retain customers greater.”

54 Abbey National was asked about its homeowner review service. Its response said that it was sending homeowner review letters to its existing borrowers over several months. It produced the text of these. This made no specific reference to the possibility of switching to the *Classic* rate. The nearest it came was to say:

“So if your circumstances have changed, and you wish to borrow more to improve your home, are thinking of moving home or want to save money on your mortgage, please feel free to take advantage of our Homeowner’s Review Service.” [my underlining]

Mr and Mrs G’s arguments

55 Mr and Mrs G put forward their arguments fully. I have carefully considered all of the points they made. The following is only a summary. Mr and Mrs G said:

- They specifically asked to be switched to the tracker rate, which Abbey National refused to allow unless they repaid the cashback. They had never argued that Abbey National should have switched them automatically, or without their permission. So Abbey National’s arguments on these points were not relevant.
- The term “*standard variable interest rate*” meant the ongoing variable interest rate paid by borrowers when they were not receiving some kind of special introductory rate. Whether or not it happened to track some other rate was not relevant. They were not aware of any law or convention that said a standard variable rate could not be a tracker rate.
- In 1996 the “*standard variable interest rate*” applied to all Abbey National’s variable-rate borrowers who were not receiving some sort of introductory interest rate, including those free to switch because they were not tied in. The changes in 2001 had deliberately detached the rate for ‘tied-in’ borrowers from the rate for ‘free-to-switch’ borrowers.
- There is no commercial pressure to keep what Abbey National now calls its *Standard Variable Rate* at a competitive level. It is a discriminatory penalty rate – higher than the reversionary rate payable by new borrowers after their special deal expires. And it is a rate no ‘free-to-switch’ existing borrowers need pay. Indeed, Abbey National itself invited such borrowers to switch to one of the tracker rates.
- In December 1996, when they applied for their mortgage, Abbey National was constrained to keep its standard variable rate competitive. *Moneyfacts* showed the following standard variable rates for high-street lenders:

- 6.99% for Abbey National
 - 6.69% for Alliance & Leicester
 - 6.99% for Bank of Scotland
 - 6.99% for Barclays
 - 6.74% for Bradford & Bingley
 - 6.99% for Bristol & West
 - 6.99% for Britannia
 - 6.85% for Cheltenham & Gloucester
 - 6.99% for Halifax
 - 6.99% for HSBC
 - 6.74% for Nationwide
 - 6.99% for National Westminster
 - 6.99% for Northern Rock
 - 6.99% for The Royal Bank of Scotland
 - 6.99% for Woolwich
 - average = 6.95%
 - [lenders charging more than Abbey National = 0]
 - [lenders charging the same as Abbey National = 11]
 - [lenders charging less than Abbey National = 3]
- In March 2001, immediately before Abbey National introduced its tracker range, Abbey National was still constrained to keep its standard variable rate competitive. *Moneyfacts* showed the following standard variable rates for high-street lenders:
- 7.44% for Abbey National
 - 7.49% for Alliance & Leicester
 - 7.45% for Bank of Scotland
 - 7.50% for Barclays
 - 7.49% for Bradford & Bingley
 - 7.50% for Bristol & West
 - 7.39% for Britannia
 - 7.50% for Cheltenham & Gloucester
 - 7.50% for Halifax
 - 6.50% for HSBC
 - 6.99% for Nationwide
 - 7.49% for National Westminster
 - 7.50% for Northern Rock
 - 7.49% for The Royal Bank of Scotland
 - 7.50% for Woolwich
 - average = 7.38%
 - [lenders charging more than Abbey National = 11]
 - [lenders charging the same as Abbey National = 0]
 - [lenders charging less than Abbey National = 3]
- By March 2002, Abbey National was no longer constrained to keep its standard variable rate competitive. *Moneyfacts* showed the following standard variable rates for high-street lenders:
- 6.10% for Abbey National
 - 5.95% for Alliance & Leicester
 - 5.80% for Bank of Scotland
 - 5.95% for Barclays
 - 5.95% for Bradford & Bingley
 - 5.95% for Bristol & West
 - 5.89% for Britannia
 - 5.95% for Cheltenham & Gloucester
 - 5.75% for Halifax

- 4.75% for HSBC
 - 4.74% for Nationwide
 - 5.95% for National Westminster
 - 5.85% for Northern Rock
 - 5.95% for The Royal Bank of Scotland
 - 5.95% for Woolwich
 - average = 5.77%
 - [lenders charging more than Abbey National = 0]
 - [lenders charging the same as Abbey National = 0]
 - [lenders charging less than Abbey National = 14]
- It had taken less than a year for Abbey National to open up this significant gap with other high-street lenders. If Abbey National's arguments were accepted, there would be nothing to prevent its continuing to widen the gap for its tied-in variable-rate customers.
 - It would not be correct to compare their position with new borrowers taking out the cashback *Classic* rate. Those new borrowers knew they were agreeing to pay a premium of 0.85% in return for the cashback. But Mr and Mrs G had signed up on the basis that they would pay the *same* standard variable rate as borrowers who were free to switch.
 - The existence of a tie-in does not necessarily indicate that the rate is a premium one. Indeed, the reverse is more likely to be true. Abbey National continues to offer discount-rate and fixed-rate mortgages with tie-ins. Is it suggesting that its discount and fixed rates are premium rates?
 - The tie-in is intended to compensate the lender if the borrower pays off the mortgage early. It is not supposed to be a device to trap borrowers into increasingly uncompetitive rates.
 - Abbey National claimed Mr and Mrs G did not say they had been misled into thinking that the basic *Classic* tracker rate was the standard variable rate – and cited the last paragraph on page 2 of their letter of 14 March 2001. But that said “... *the SVR is effectively being replaced by a choice of a tracker rate ... or a flexible mortgage ...*”

My comments on potentially similar cases

56 Abbey National has contrasted its position to that of other lenders in potentially similar cases previously decided by the Financial Ombudsman Service. So it is appropriate that I comment briefly on that context, though my decision in this case is based on what I consider to be fair in all the circumstances of this case. There have been ombudsman final decisions against three mortgage lenders in potentially similar cases.

57 In lender A's case:

- Lender A originally had one standard variable mortgage rate. It introduced a new and lower variable rate with a different name. It used the new lower rate for new variable-rate borrowers, and also transferred most of its existing variable-rate borrowers to the new lower rate automatically.
- Mr and Mrs A complained that lender A continued to use a higher rate, which it described as its standard variable rate, as the yardstick for their discount-rate

mortgage. Mr and Mrs A considered that the new lower rate had become the yardstick for their discount rate.

- The ombudsman decided that case in the light of the particular circumstances. These included the description, in Mr and Mrs A's mortgage contract, of the rate to which their discount rate was linked.
- In effect, the ombudsman decided that the new lower rate had become the yardstick for Mr and Mrs A's discount rate. This had happened automatically, from the date the new lower rate was introduced.

58 In lender B's case, the circumstances had similarities:

- Lender B originally had one standard variable mortgage rate. It introduced a new and lower variable rate with a different name. It used the new lower rate for new variable-rate borrowers, and also transferred most of its existing variable-rate borrowers to the new lower rate automatically.
- Mr and Mrs B complained that lender B continued to use a higher rate, which it described as its standard variable rate, as the yardstick for their discount-rate mortgage. Mr and Mrs B considered that the new lower rate had become the yardstick for their discount rate.
- The ombudsman decided that case in the light of the particular circumstances. These included the description, in Mr and Mrs B's mortgage contract, of the rate to which their discount rate was linked.
- In effect, the ombudsman decided that the new lower rate had become the yardstick for Mr and Mrs B's discount rate. This had happened automatically, from the date the new lower rate was introduced.

59 In lender C's case, there were significant differences:

- Lender C originally had one standard variable rate. It introduced a new and lower variable rate with a different name. It used the new lower rate for new borrowers. It advertised widely that its existing variable-rate borrowers could apply to transfer to the new lower rate.
- Lender C did not transfer any of its existing variable-rate borrowers to the new lower rate automatically. It said this was because the new lower rate came with interest calculated daily, rather than yearly as before. Existing borrowers needed to sign up to new mortgage conditions before they could transfer to the new lower rate.
- Mr and Mrs C had a capped-rate mortgage, under which they were to pay the standard variable rate or a specified capped rate (whichever was lower). The new lower rate was less than the specified capped rate.
- Mr and Mrs C complained that lender C refused their application to link their capped-rate mortgage to the new lower rate unless they first paid the early repayment charge attached to their capped rate.
- The ombudsman decided that case in the light of the particular circumstances. These included the description, in Mr and Mrs C's mortgage contract, of the rate to which their capped rate was linked.

- In effect, the ombudsman decided:
 - Mr and Mrs C agreed to pay the early repayment charge in return for the capped rate. Lender C had agreed that otherwise it would treat them like ordinary variable-rate borrowers with no early repayment charge.
 - Ordinary variable-rate borrowers with no early repayment charge were allowed to transfer to the new lower rate. So Mr and Mrs C should have been allowed to link to the new lower rate without paying the early repayment charge.
 - Because the new lower rate was only available to ordinary variable-rate borrowers on application, Mr and Mrs C should have been linked to it from the date they applied – not from the date it was introduced.
- [Following that ombudsman final decision, lender C closed the new lower rate to anyone not already on it. Miss D complained. She had a capped-rate mortgage and had not applied to be linked to the new rate until after it was closed. The ombudsman final decision in that case went in favour of the lender.]

My comments on Abbey National's arguments

60 I have some comments on Abbey National's arguments. My comments include references to 'no-frills' mortgages, by which I mean mortgages:

- that did not incorporate any special deal (such as a discounted rate, capped rate, fixed rate or cashback); and
- where the borrowers were not tied in - for example, by an early repayment charge or a requirement to repay a cashback.

61 In connection with Abbey National's arguments about the history of its "*standard variable interest rate*":

- It sought to draw a distinction between a rate and a product, without defining either expression. I am not sure that such a distinction is particularly helpful. But I consider that, for my purposes and in the context of a mortgage:
 - A rate comprises the calculation of the amount of interest payable. So, for example, a rate of 5% calculated yearly differs from a rate of 5% calculated daily – because they will usually result in a different amount being payable.
 - A product comprises the rate and all the other terms of a particular type of mortgage (or, at least, all the terms that are not identical in every one of a particular lender's types of mortgage).
- In arguing its case, Abbey National sought to dismiss its "*standard variable interest rate*" as an uncompetitive premium rate, largely irrelevant to Abbey National borrowers. But this is contradicted by its answers to questions (which preceded its arguments), when it said:
 - "*A great many customers pay the standard variable rate, not just those that are contractually obliged to do so by virtue of having benefited from a fixed/capped/discount rate or a cashback mortgage. Of the total number of customers who pay the SVR, approximately just 12% of them are 'tied' to paying it as a result of their contractual obligations.*"

- “Standard Variable Rate remains a rate commonly paid by customers both internally and in the mortgage market. The mortgage market is extremely competitive, information is widely available and it is very easy for borrowers to move between lenders.”
- “Retention of existing customers is as key to a lenders (sic) success, as recruiting new business, it is essential to ensure that the Standard Variable rate remains competitive as well as new business upfront deals. Standard Variable Rate is a managed rate, but the amount by which it can be changed will be subject to the commercial constraint of remaining competitive.”
- It may be that, as a result of competitive pressures, Abbey National offered many special deals – such as time-limited discounts off the standard variable rate. By definition, such discounted rates had to be more competitive than the standard variable rate. But those mortgages reverted to the standard variable rate once the time-limited discount expired.
- It is unrealistic to suggest that this made the standard variable rate a premium rate. That would have required the discounted rate to be the basic rate. But, by definition, it cannot have been the basic rate if it was a discounted rate. And the contractual rate payable for the majority of the mortgage term, once the time-limited discount period expired, was the standard variable rate.
- I note that *Moneyfacts* considered standard variable rates sufficiently important to justify a list of those rates as charged by all the high-street lenders.

62 In connection with Abbey National’s arguments about its approach to the introduction of new interest rates in 2001:

- I accept that Abbey National’s position was different from lender A and lender B. Abbey National did not automatically transfer any of its existing borrowers to the new tracker rates. And Mr and Mrs G do not suggest that they should have been transferred automatically.
- Mr and Mrs G did, however, argue that they should have been transferred to the basic *Classic* rate after they asked for it. So there are some parallels with lender C; though some features differ. But I have decided this case in the light of all its own circumstances.

63 In connection with Abbey National’s arguments about its press release of 5 March 2001:

- Abbey National is one of the market leaders in the mortgage market. The press release related to a significant change in its approach to that mortgage market, which represented a significant proportion of its business. The press release included a substantial quotation from the Managing Director of Retail Banking.
- So it hardly conceivable that the press release was not crafted with considerable care, to communicate the message that Abbey National wished to put over – even though Abbey National now wishes to distance itself from that message and the natural meaning of its own words.
- I do not accept that inadvertence led to clear references:
 - to “*the new variable rates*”;
 - to the tracker rate mortgages as “*the new variable rate mortgages*”; and

- in the “*Editors Notes*”, to “*new standard variable rates*”.
- I do not accept that the “*Editors Notes*” did not form part of the press release. Notes 1 to 3 are clearly referenced within the text of the press release – by the bracketed numbers that I have underlined in my quotation of that text.
- I do not accept that the “*Editors Notes*” were not ‘reasonably available’ for the purpose of the test in *Investors Compensation Scheme v West Bromwich Building Society and others*. The full press release, including the “*Editors Notes*”, was supplied to the Financial Ombudsman Service by Mr and Mrs G. And the full press release, including the “*Editors Notes*”, is still on the Abbey National plc website for all to see.
- I do not accept that the reference to “*a definitive sell-by date on Abbey National’s present standard variable rate*” was clearly directed primarily at new customers. That is not consistent with the wording of the relevant paragraph, which quotes the Managing Director of Retail Banking as saying:

“Today’s announcement stamps a definitive sell-by date on our present standard variable rate - good news for existing and new customers. I’m adamant that the launch of our new variable rates will provide us with the means to retain and reward all our customers, helping to ensure that customers who come in through the front door on introductory deals do not want or need to slip quietly out of the back door months later.” [my underlining]

- The press release also said [the emboldening, significantly, is Abbey National’s]:
- “The new variable rate mortgages will also be available from 30 April 2001 to **all existing** Abbey National mortgage customers who are not on special deals.(3)*
- I accept that a press release could not alter the terms of Mr and Mrs G’s mortgage contract. But the press release is highly relevant to Abbey National’s strategy and its intentions concerning its standard variable rate – and, therefore, relevant to the interpretation of Mr and Mrs G’s mortgage contract and their legitimate expectations.

64 In connection with Abbey National’s arguments about the variable rate it charged Mr and Mrs G from 25 April 2001:

- I accept that this was the rate Abbey National called its *Standard Variable Rate*. But the name Abbey National chose is not conclusive.
- I do not accept that the rate Abbey National called its *Standard Variable Rate* was the only rate that Abbey National was free to alter. It was free to alter the tracker rates, by altering the “*tracking differential*”.
- I accept that an essential characteristic of a ‘standard variable’ rate is that it varies. The key point about a ‘variable’ rate is that it is not a fixed rate. I do not consider that a rate which varies because it tracks another rate cannot ordinarily be called a ‘variable’ rate. But I note that, for Mr and Mrs G’s mortgage contract, Abbey National’s 1995 Mortgage Conditions defined “*variable rate*” in a specific way.
- Abbey National described itself as being ‘free to alter’ the rate. But it is necessary to bear in mind the important qualification that the lender’s ‘freedom’ is constrained

by the terms of the mortgage contract, the Unfair Terms in Consumer Contracts Regulations and the Consumer Credit Act 1974.

- I do not accept that variability (or variability by the lender, if that is what the mortgage contract says) is the only essential characteristic of a ‘standard variable’ rate. The word ‘standard’ appears first, and cannot be ignored. In this context, I consider that ‘standard’ denotes the ordinary or usual variable rate.
- Abbey National’s March 2001 press release referred to a “*sell-by date*” being stamped on its “*standard variable rate*”, and referred to the tracker rates as “*new standard variable rates*”. The clear implication was that the existing “*standard variable rate*” had been replaced, or soon would be.
- It is difficult to see how a rate which is, or soon will be, past its shelf-life can properly be described as ‘standard’, particularly when new and lower variable rates (unconnected with special mortgage-rate deals) are available.

65 In connection with Abbey National’s arguments about its tracker rates introduced from 25 April 2001:

- I do not accept that the basic *Classic* rate had never been published as Abbey National’s standard variable rate. I have already commented on the contents of the press release. And it was published as the rate for the purposes ordinarily fulfilled by a standard variable rate – for example, as the no-frills variable rate for new borrowers, and the reversionary rate for new discount/capped/fixed-rate mortgages.
- The Unfair Terms in Consumer Contracts Regulations contain, in Schedule 2 of the 1994 Regulations and Schedule 3 of the 1999 Regulations, similar provisions that are relevant to a mortgage lender in drafting an interest-variation clause that is not unfair. These provisions give rise to alternative possible approaches:
 - One is to say that that the lender can only alter the interest rate for valid reasons, and to specify valid reasons in the contract [paragraph 1(j)]. This is what the 1995 Mortgage Conditions did in defining the “*variable rate*”.
 - Another is to link the rate to some external benchmark rate over which the lender has no control [paragraph 2(c)]. This is what the 2001 Mortgage Conditions did in defining the “*base rate*”.
 - Another is to reserve the right to alter the interest rate without specifying valid reasons in the contract, but to allow borrowers to escape the change by letting them redeem without paying any charge that ties them in [paragraph 2(b)]. This is what the 2001 Mortgage Conditions did in defining the “*tracking rate*”.
- Abbey National contrasted the position created by its 1995 and 2001 Mortgage Conditions, and suggested that the 2001 version is more onerous for Abbey National when it comes to interest-rate changes. In reality, this is not a gratuitous bounty conferred by Abbey National on its borrowers.
- It simply chose an alternative approach to retaining its ability to vary the mortgage rate whilst meeting its obligations under the Unfair Terms in Consumer Contracts Regulations. It would not be fair to treat this alternative approach to protecting borrowers as affecting Mr and Mrs G’s position adversely.

- Abbey National claimed that, because of commercial constraints, the “*tracking differential*” under the 2001 Mortgage Conditions would not be changed except in exceptional circumstances. But a variable rate does not cease to be a variable rate just because there are commercial constraints (maybe severe ones) on varying it.
- The 1995 Mortgage Conditions contained different constraints. Abbey National could only vary the rate during a tie-in period for one of the reasons specified in paragraph 9.2. This limitation must be contrasted with the 2001 version, which allowed changes to the “*tracking differential*” for *any* reason.
- And Abbey National itself had already indicated that there were significant constraints on varying a standard variable rate, when it said:
 - “*Standard Variable Rate remains a rate commonly paid by customers both internally and in the mortgage market. The mortgage market is extremely competitive, information is widely available and it is very easy for borrowers to move between lenders.*”
 - “*Retention of existing customers is as key to a lenders (sic) success, as recruiting new business, it is essential to ensure that the Standard Variable rate remains competitive as well as new business upfront deals. Standard Variable Rate is a managed rate, but the amount by which it can be changed will be subject to the commercial constraint of remaining competitive.*”
- I do not accept that the position is altered by Abbey National’s promise that – until 1 January 2003 – the basic Classic rate will not exceed Bank of England repo rate by more than 0.9%.
 - That promise is not incorporated in the 2001 Mortgage Conditions. They give Abbey National power to alter the relationship between the basic *Classic* rate and Bank of England repo rate, by altering the “*tracking differential*”. So its promise is that it will not exercise a right it possesses.
 - If Abbey National had made a similar promise, that it would not – for some specified period – exercise its contractual right to alter the rate, about the standard variable rate in 2000, that would not have meant that the standard variable rate would have ceased to be the standard variable rate.
 - The government’s ‘CAT’ standards say that variable mortgage rates should be no higher than 2% above Bank of England repo rate. I do not consider that such a link means that a CAT-standard variable rate cannot be a standard variable rate.

66 In connection with Abbey National’s arguments about the interpretation of Mr and Mrs G’s mortgage:

- I do not read the adjudication as turning on a pure point of law. In any event, my decision does not turn on a pure point of law. I make my decision, as I am required to do, on the basis of what I consider to be fair in all the circumstances of the case.
- I consider that a reasonable person with all the background knowledge reasonably available to the parties at the time of the contract *would* have expected Mr and Mrs G’s mortgage contract to be affected by the subsequent introduction of a rate

which was used to replace the standard variable rate – whatever that new rate was called, however it was set and calculated, and whatever conditions governed it.

- Mr and Mrs G have not suggested that Abbey National was required to switch them to the basic *Classic* tracker rate automatically.

67 In connection with Abbey National's arguments about the effect of its Mortgage Conditions on the interpretation of Mr and Mrs G's mortgage:

- Paragraph 9.5 of the 1995 Mortgage Conditions gave Abbey National power to alter the "*interest period*" for Mr and Mrs G's mortgage to one month – which was the period used in the 2001 Mortgage Conditions.
- But this would have meant interest being calculated under the 1995 Conditions on the capital balance at the beginning of each month, rather than on the capital balance each day as with the 2001 Mortgage Conditions.
- The 1995 Mortgage Conditions contained no express power enabling Abbey National to change from calculating interest on the balance at the beginning of each "*interest period*" to calculating it on the capital balance each day.
- Such a change would have benefited most borrowers. But it would have had an adverse effect on borrowers who accrued capital arrears during the "*interest period*". That would have been marginal if the "*interest period*" had been reduced to one month. And, conversely, borrowers in financial difficulties would have derived most benefit from any reduction in the interest rate payable.
- Mr and Mrs G did not claim to be automatically entitled to the basic *Classic* rate. They claimed to be entitled to it on application. They asked for it after it was announced and before it was introduced. So, *if* they were entitled to it on application, they were entitled to it from 25 April 2001 on the mortgage they had at that time.

68 In connection with Abbey National's arguments about the cashback:

- I do not accept that the standard variable rate was the 'price' Mr and Mrs G agreed to pay for choosing to have a cashback. The 'price' they agreed to pay was the obligation to repay the cashback if they redeemed the mortgage on or before 31 January 2003.
- I do not accept that the existence of a tie-in period would have demonstrated to a reasonable person that the rate payable during the tie-in period was uncompetitive, or was bound to be higher than the rate payable by a borrower with no cashback. Tie-ins are common, and can attach to discount/capped/fixed/tracker rates also.
- I consider that a reasonable person would have expected that the variable rate available to Mr and Mrs G would be the same as the variable rate available to a borrower with a no-frills mortgage.
- At the relevant time, there was no higher standard variable rate for cashback mortgages. So, if any comparison is to be made between the standard variable rate and the rates charged for products in the *Classic* tracker range, the comparison should be with the basic *Classic* rate, not the higher cashback *Classic* rate.

- The District Judge’s decision in the County Court case of *Wright v Abbey National* is not binding precedent even in a court of law. And it is directed primarily to the validity of an early repayment charge. This was an issue on which the adjudicator found in Abbey National’s favour – a result that Mr and Mrs G have not disputed.
- 69 In connection with Abbey National’s arguments about the potentially wider consequences of the adjudicator’s decision:
- On Abbey National’s own figures, it does not necessarily pitch its rates in order to obtain a profit by the end of any tie-in period. It takes into account the opportunity of selling other products, and the value of the prospective ongoing relationship.
 - If Mr and Mrs G were entitled (like standard variable rate borrowers with no tie-in) to the basic *Classic* rate on application, any consequent loss would arise from the level at which Abbey National pitched that rate – not from the definition of Mr and Mrs G’s entitlement.
 - It would not be fair and reasonable to deny Mr and Mrs G something to which they were entitled simply because that would have adverse consequences for Abbey National. Denying Mr and Mrs G their entitlement would have adverse consequences for them.
 - The ‘logic’ of Abbey National’s argument is that a lender would be justified in treating a borrower unfairly if the lender would suffer a loss by paying compensation – or that any compensation would have to be limited to a sum which put the lender in a break-even situation.
 - Customer choice is only meaningful if customers, having chosen, are not denied the benefits they legitimately expected. Put another way – adverse treatment of customer X cannot be justified because a lender, in seeking to retain and expand its market share, thereby advantages customers Y and Z.
- 70 In connection with what Abbey National said, in response to a request to identify the commercial constraints which restricted Abbey National’s ability to change the standard variable rate in 1996 (when it made the relevant mortgage offer to Mr and Mrs G) and now:
- I do not accept Abbey National’s contention that there has been no significant change between the commercial constraints restricting its ability to change the standard variable rate in 1996 and the commercial constraints restricting its ability to change what it calls the *Standard Variable Rate* now.
 - In 1996, the standard variable rate had to be attractive to:
 - new borrowers who wanted a no-frills mortgage;
 - new borrowers who took into account the reversionary rate payable at the end of any discount/capped/fixed rate; and
 - existing variable-rate borrowers who were not tied in.
 - Now, what Abbey National calls its *Standard Variable Rate* need not be attractive to:

- new borrowers who want a no-frills mortgage (who, unless they opt for the higher-cost fully-flexible mortgage, are offered the basic *Classic* rate);
 - new borrowers who take into account the reversionary rate payable at the end of any discount/capped/fixed rate (who, unless they opt for the higher-cost fully-flexible mortgage, revert to the basic *Classic* rate);
 - existing variable-rate borrowers who are not tied in (who are allowed to transfer to the basic *Classic* tracker rate).
- Now, the only existing variable-rate borrowers whom Abbey National does not allow to transfer to the lower basic *Classic* rate – and whom Abbey National requires to go on paying what it calls its *Standard Variable Rate* – are those who would have to pay off a tie-in. So any commercial constraint on what Abbey National calls its *Standard Variable Rate* is severely limited.
- If it is unfair for a lender to take “*advantage of the captive status of its 'locked in' borrowers by imposing on them a rate change which it is not also prepared to impose on its new and non-captive borrowers*” [Wurtzburg and Mills - Building Society Law at paragraphs 6/30-6/31], I consider that it is equally unfair for a lender to take advantage of the captive status of its 'locked in' borrowers by leaving them marooned on a rate which none of its new and non-captive borrowers is required to pay.

My comments on Mr and Mrs G's arguments

71 I have some observations on Mr and Mrs G's arguments:

- I accept that existing variable-rate borrowers are allowed to apply for the basic *Classic* rate.
- I have not seen any evidence that Abbey National actually invited such borrowers to switch. The text of Abbey National's homeowner review letters to existing borrowers made no specific reference to the possibility of switching to a tracker rate. The nearest it came was to say –

“*So if your circumstances have changed, and you wish to borrow more to improve your home, are thinking of moving home or want to save money on your mortgage, please feel free to take advantage of our Homeowner's Review Service.*” [my underlining]
- But the press release of 5 March 2001 indicated that the Homeowner's Review Service *would* result in those borrowers being invited to switch. It said:

“*Abbey National will contact all existing mortgage customers over the next 12 months to offer them a homeowner's review. This will involve discussing their mortgage and financial needs, and seeing if they would like to move to either the new tracker or new flexible mortgage deals.*” [my underlining]
- Our copies *Moneyfacts* for December 1996, March 2001 and March 2002 show slightly different figures from those quoted by Mr and Mrs G. I set these out below, underlining any differences. Where different rates are quoted for existing and new borrowers, I have quoted the existing-borrower rates.

- December 1996:
 - o 7.04% for Abbey National
 - o 6.69% for Alliance & Leicester
 - o 6.99% for Bank of Scotland
 - o 6.99% for Barclays
 - o 6.74% for Bradford & Bingley
 - o 6.99% or 7.29% for Bristol & West
 - o 6.99% for Britannia
 - o 6.85% for Cheltenham & Gloucester
 - o 6.99% for Halifax
 - o 6.99% for HSBC [then Midland]
 - o 6.74% for Nationwide
 - o 6.99% for National Westminster
 - o 6.99% for Northern Rock
 - o 6.99% for The Royal Bank of Scotland
 - o 6.99% for Woolwich

- Using (a) the higher or (b) the lower Bristol & West rate:
 - o lenders charging more than Abbey National = (a) 1 or (b) 0
 - o lenders charging the same as Abbey National = (a) 0 or (b) 0
 - o lenders charging less than Abbey National = (a) 13 or (b) 14

- March 2001, immediately before Abbey National introduced its tracker range:
 - o 7.49% for Abbey National
 - o 7.49% for Alliance & Leicester
 - o 7.45% for Bank of Scotland
 - o 7.50% for Barclays
 - o 7.49% for Bradford & Bingley
 - o 7.50% for Bristol & West
 - o 7.39% for Britannia
 - o 7.50% for Cheltenham & Gloucester
 - o 7.50% or 6.75% for Halifax
 - o 6.50% for HSBC
 - o 6.49% for Nationwide
 - o 7.49% for National Westminster
 - o 7.50% for Northern Rock
 - o 7.49% for The Royal Bank of Scotland
 - o 7.50% for Woolwich

- Using (a) the higher or (b) the lower Halifax rate:
 - o lenders charging more than Abbey National = (a) 6 or (b) 5
 - o lenders charging the same as Abbey National = (a) 4 or (b) 4
 - o lenders charging less than Abbey National = (a) 4 or (b) 5

- March 2002:
 - o 6.10% or 4.90% for Abbey National
 - o 5.95% for Alliance & Leicester
 - o 5.80% for Bank of Scotland
 - o 5.95% for Barclays [but in the form of a cross-reference to Woolwich]
 - o 5.95% for Bradford & Bingley
 - o 5.95% or 5.00% for Bristol & West
 - o 5.89% for Britannia
 - o 5.95% for Cheltenham & Gloucester
 - o 5.75% or 5.00% for Halifax

- 4.75% for HSBC
 - 4.74% for Nationwide
 - 5.95% for National Westminster
 - 5.85% for Northern Rock
 - 5.95% for The Royal Bank of Scotland
 - 5.95% for Woolwich
- Perhaps significantly, *Moneyfacts* included the 4.90% *Classic* rate in the table. Using the 6.10% that Abbey National called its *Standard Variable Rate* and, where two rates are quoted for other lenders, irrespective whether the higher or lower rates are used:
- lenders charging more than Abbey National = 0
 - lenders charging the same as Abbey National = 0
 - lenders charging less than Abbey National = 14
- If Abbey National’s arguments were accepted, Abbey National would not be completely unconstrained in opening up the gap between, on the one hand, the rate it calls its *Standard Variable Rate* and, on the other hand, its basic *Classic* rate and the standard variable rates of other high-street lenders.
- That is because the 1995 Mortgage Conditions require that any increase in the rate must be for valid reasons and because there are still some (albeit limited) commercial constraints on interest rate rises. Nevertheless, this has not prevented Abbey National’s opening up the gap to some extent and would not prevent its opening up the gap further.

Decision

72 The name Abbey National chooses to give a particular rate is not conclusive. I take into account what Abbey National’s “*standard variable interest rate*” would have meant, in connection with Mr and Mrs G’s mortgage, to a reasonable person who had all the background knowledge reasonably available to the parties at the time.

73 The background knowledge reasonably available included the context in which variable-rate mortgages operate:

- Until 2001 Abbey National (like other lenders) had a single variable mortgage interest rate. This was set and varied by Abbey National against the background of, not only general interest rates, but also Abbey National’s need to maintain a position in the competitive mortgage market.
- This single rate was generally paid by existing and new borrowers who had ‘no-frills’ mortgages – by which I mean mortgages:
 - that did not incorporate any special deal (such as a discounted rate, capped rate, fixed rate or cashback); and
 - where the borrowers were not tied in - for example, by an early repayment charge or a requirement to repay a cashback.
- Such no-frills mortgages must be distinguished from:
 - the special deals that Abbey National (like other lenders) would offer from time to time; and

- any increased variable rates that Abbey National (like other lenders) charged to reflect the increased risk of mortgages with a high loan-to-value ratio.
 - Those special deals might include a special mortgage rate (fixed, discounted or capped) for a specified period. In return, the borrowers might be required to pay an early repayment charge if they redeemed the mortgage before a specified date. But, after the specified period, the rate would revert to the single variable mortgage rate payable on no-frills mortgages.
 - Those special deals might include a cashback, either alone or in combination with a time-limited special mortgage rate. In return, the borrowers might be required to repay the cashback if they redeemed the mortgage before a specified date.
 - The rate Abbey National asked Mr and Mrs G to pay as a result of the mortgage offer dated 31 December 1996 was the same as that for any other customer who had, or wanted, a no-frills mortgage. [Although it would not have been known at the time, this remained the position until 25 April 2001.]
 - Unless a variable mortgage rate is linked directly to an external benchmark, without the lender being able to vary any differential, the lender is in a much more powerful position than the borrower. It is the lender that has discretion to vary the interest rate from time to time. This could result in a very one-sided bargain.
 - That one-sidedness is mitigated, to some extent, by the Unfair Terms in Consumer Contracts Regulations. But these focus on: the necessity for a valid reason for any change; whether notification has to be given to the borrower; and whether the borrower has to be free to end the contract. The Regulations have little impact on the *amount* of any change.
 - That one-sidedness is also mitigated, to some extent, by the Consumer Credit Act 1974. This allows a court to interfere where an interest rate is extortionate or a variable rate is altered irrationally. But these powers are limited to extreme cases, falling well outside what most borrowers would consider to be a reasonable variation.
 - So why do borrowers enter into such an apparently one-sided arrangement? They do so (and a mortgage lender knows they do so) because borrowers have a legitimate expectation that the lender intends to retain its customer base in a competitive market, and that the lender will set the available going rate for no-frills mortgages accordingly.
 - That is especially so where the borrowers are tied-in – because they cannot escape from the lender (and the rate it sets) without significant cost.
- 74 The background knowledge reasonably available about Abbey National mortgages on 31 December 1996 included:
- New borrowers who wanted a no-frills mortgage were offered the “*standard variable interest rate*”.
 - New borrowers who wanted a discount-rate special deal were offered one that:
 - used the “*standard variable interest rate*” as yardstick; and
 - reverted to the “*standard variable interest rate*” when the special deal period ended.

- New borrowers who wanted a capped-rate special deal were offered one that:
 - used the “*standard variable interest rate*” as yardstick; and
 - reverted to the “*standard variable interest rate*” when the special deal period ended.
 - New borrowers who wanted a fixed-rate special deal were offered one that reverted to the “*standard variable interest rate*” when the special deal period ended.
 - New borrowers who wanted a variable-rate with a cashback deal were offered one with the “*standard variable interest rate*”.
 - Existing borrowers with no-frills mortgages paid the “*standard variable interest rate*”.
- 75 When Mr and Mrs G took out their mortgage, they had a legitimate expectation that they would be treated like ordinary variable-rate borrowers with no-frills mortgages, except in two respects:
- First, they would receive the cashback.
 - Second, and in return, they would repay the cashback if they redeemed their mortgage on or before 31 January 2003.
- 76 Mr and Mrs G did not have a no-frills mortgage themselves. They had a ‘frill’ – the benefit of the cashback, coupled with the burden of repaying it if they redeemed on or before 31 January 2003. But they were not supposed to pay a higher rate than that available to borrowers with no-frills mortgages, who were not tied-in, and who were free to move their mortgage to another lender if dissatisfied with the rate.
- 77 So I consider that a reasonable person, with all the background knowledge reasonably available to the parties at the time, would have said that the capped-rate deal included a promise by Abbey National that:
- the rate available to Mr and Mrs G would be no more than the going rate available to borrowers with no-frills mortgages; and
 - Abbey National would pitch that going rate so as to maintain its customer base in a competitive market.
- 78 In order to decide whether or not Abbey National broke that promise after 25 April 2001, I have to consider two questions.
- Did Abbey National have a going rate available to borrowers with no-frills mortgages?
 - If so, did Abbey National allow this rate to be available to Mr and Mrs G?
- 79 After 25 April 2001:
- New borrowers who wanted a no-frills mortgage, and did not opt for a (higher-cost) fully-flexible mortgage, were offered the basic *Classic* rate.
 - New borrowers who wanted a discount-rate special deal, and did not opt for a (higher-cost) fully-flexible mortgage, were offered one that:

- used the basic *Classic* rate as yardstick; and
 - reverted to the basic *Classic* rate when the special deal period ended.
- New borrowers who wanted a capped-rate special deal, and did not opt for a (higher-cost) fully-flexible mortgage, were offered one that:
 - used the basic *Classic* rate as yardstick; and
 - reverted to the basic *Classic* rate when the special deal period ended.
 - New borrowers who wanted a fixed-rate special deal, and did not opt for a (higher-cost) fully-flexible mortgage, were offered one that reverted to the basic *Classic* rate when the special deal period ended.
 - New borrowers who wanted a variable-rate with a cashback deal, and did not opt for a (higher-cost) fully-flexible mortgage, were offered one with a clear mark-up from the basic *Classic* rate.
 - Existing borrowers with no-frills mortgages were allowed to transfer to the basic *Classic* rate.
- 80 The rate which Abbey National now calls its *Standard Variable Rate*:
- is not offered to new customers seeking a no-frills mortgage; and
 - is not a rate which existing borrowers with no-frills mortgages are bound to pay.
- 81 In those circumstances, I consider that:
- Abbey National did indeed have a going rate available to borrowers with no-frills mortgages. The rate that most nearly, indeed almost perfectly, complied with the description from 25 April 2001 was the basic *Classic* rate.
 - The basic *Classic* rate was the rate that a reasonable person would consider to be the equivalent of the “*standard variable interest rate*” that was referred to in Mr and Mrs G’s capped-rate deal.
- 82 Did Abbey National allow this rate to be available to Mr and Mrs G after 25 April 2001?
- Abbey National was not prepared to allow Mr and Mrs G the basic *Classic* rate, unless they repaid the cashback.
 - But the requirement to repay the cashback was to encourage them to keep their mortgage with Abbey National on the no-frills going rate until 31 January 2003.
 - It was not intended as a way to penalise them if they were not prepared to pay more than the no-frills going rate.
 - Accordingly, I consider that Abbey National did break its promise to Mr and Mrs G.
- 83 When did Abbey National break its promise to Mr and Mrs G?
- Existing ordinary variable-rate borrowers with no-frills mortgages were not transferred to the basic *Classic* rate automatically. They first had to apply and sign up to the 2001 Mortgage Conditions.
 - That was because the *Classic* rate was calculated on the capital balance outstanding each day, rather than the capital balance outstanding at the beginning of the interest period.

- That change, which would benefit most borrowers (all those who had not incurred arrears during the interest period), was a legitimate commercial decision for Abbey National to take.
- So Abbey National did not break its promise to Mr and Mrs G when it announced the basic *Classic* rate or when it introduced the new rate. It broke its promise when it indicated that Mr and Mrs G would not be allowed to proceed with an application unless they repaid the cashback.

84 From when should compensation run?

- Abbey National's liability to compensate Mr and Mrs G dates from when it broke its promise. Its promise was broken - when it indicated that Mr and Mrs G would not be allowed to proceed with an application unless they repaid the cashback - before the new rate was actually introduced.
- But Mr and Mrs G's loss only started to run once the new rate was introduced on 25 April 2001. As Abbey National had broken its promise to them before that date, and in all the circumstances of this case, compensation should run from 25 April 2001.

85 Accordingly:

- Abbey National should recalculate at the basic *Classic* tracker rate, from 25 April 2001, that part of Mr and Mrs G's mortgages which were on a variable rate;
- Abbey National should refund any overpayment and also pay Mr and Mrs G £150 for the inconvenience they had been caused.

Banking Code

86 The Banking Code does not apply to mortgages, and it has played no part in my decision. But it is interesting to speculate what the result might have been if Abbey National had treated Mr and Mrs G's mortgage account as the Banking Code would have required Abbey National to treat a savings account.

87 The Banking Code says that a type of account that is no longer opened, or is not actively promoted, is 'superseded'. To ensure the interest rate remains at an appropriate level, the financial firm must keep the rate at the same level as an account with similar features from its current range, or switch the money to such an account.

88 Where there is no account with similar features in its current range, the financial firm must: contact the customer to say the account is superseded; tell the customer about the firm's other accounts; and help the customer switch accounts *without any notice period and without any additional charges*.

Walter Merricks
Chief Ombudsman