

The complaint

Mr F, represented by his solicitors, complains that Nationwide Building Society treated him unfairly by overcharging him interest on his mortgage.

What happened

Mr F took out a mortgage with Nationwide in April 2008. The mortgage was taken out on Nationwide's Base Mortgage Rate (BMR), which was their standard variable rate at the time. At the time the mortgage was agreed, the BMR was 6.74%. The mortgage was taken out on a repayment basis over 21 years.

The mortgage offer stated that the BMR was guaranteed to be no more than 2% above the Bank of England base rate (base rate). It also said that any variation to the interest rate as a result of a change in the base rate would take place within one month of the announcement of such change. It said that before or after the loan is made, Nationwide may change the BMR under the Mortgage Conditions 2001, which would result in a change to the monthly payment.

Since Mr F's mortgage was taken out, the Bank of England base rate and BMR have operated as follows:

Effective Date	Base rate	BMR	Difference
30/04/2008	5%	6.74%	1.74%
01/05/2008		6.49%	1.49%
08/10/2008	4.5%		
01/11/2008		6.19%	1.69%
06/11/2008	3%		
01/12/2008		4.69%	1.69%
04/12/2008	2%		
01/01/2009		4%	2%
08/01/2009	1.5%		
01/02/2009		3.5%	2%
05/02/2009	1%		
01/03/2009		3%	2%
05/03/2009	0.5%		
01/04/2009		2.5%	2%
04/08/2016	0.25%		
01/09/2016		2.25	2%
02/11/2017	0.5%		
01/12/2017		2.5%	2%
02/08/2018	0.75%		

01/09/2018		2.75%	2%
11/03/2020	0.25%		
19/03/2020	0.1%		
01/04/2020		2.25%	
15/04/2020		2.1%	2%

So the BMR has reduced and increased when the base rate has reduced and increased, albeit not always by the same margin.

Each time the BMR changed, the interest rate applied to Mr F's mortgage also changed within the timeframes set out in the mortgage offer. The BMR was changed within one month of each base rate change, and as a result it never exceeded the 2% cap margin as per the agreed terms.

Mr F's mortgage was redeemed in January 2021.

Mr F's complaint

In March 2020 Mr F's representatives complained to Nationwide on his behalf. In summary, he complained that:

- The standard variable rate (SVR) charged on his mortgage was unfair.
- He has been overcharged interest on his mortgage payments as the SVR has been set unfairly. Mr F's representative also said Mr F believes the mortgage offer was unclear about how changes could be made to the SVR.
- He was aware of the difference between the SVR and the Bank of England base rate ('the margin') when deciding whether this mortgage was suitable for him. But the SVR hasn't varied in line with the base rate, and Nationwide have used their discretion about when and how to vary the SVR unfairly. This has caused an unfair increase in the margin.
- He was misled to believe the SVR would vary in line with the base rate, so the margin between the two would remain the same.
- He couldn't dissolve the agreement and switch to a new lender following changes to the SVR, as this would incur a cost. These limitations on Mr F's ability to repay the borrowing or transfer elsewhere meant the changes Nationwide made to the SVR were unfair.

Mr F's representatives have raised several arguments to support the overarching complaint that Mr F has been treated unfairly. This includes reference to the law, and the rules set by the Financial Conduct Authority (FCA), as well as a report prepared by a third party - '*Retail Mortgages in the UK – Lending Strategies and Borrower's issues*'. I have considered them all carefully.

Nationwide's response

Nationwide said that Mr F's complaint had been brought out of time under the time limits.

In summary, they also said that:

- The description of the BMR in the mortgage offer was not unclear and did not lack transparency. They said the offer clearly explained to Mr F:
 - When the BMR would apply.
 - What the current BMR was at the time of the offer.

- That the BMR was guaranteed to be no more than 2% above base rate.
- There was no indication within the mortgage offer, or elsewhere in the mortgage documentation that the BMR would track base rate.
- Mr F was informed of all costs and charges associated with the mortgage from the mortgage offer, the published fee tariff, and the annual mortgage statements.
- There was no Early Repayment Charge (ERC) payable on Mr F's mortgage, so there was no barrier to exiting the mortgage agreement if Mr F was unhappy with the variations made to the BMR.
- Before 2009, Mr F had benefited from their decision to maintain the BMR below the 2% cap. They were able to maintain that position in the market conditions that preceded the 2008-2010 financial crisis, but that position could not be maintained thereafter.
- The Mortgage Terms and Conditions set out a number of reasons why Nationwide could decide to vary the BMR. The variation reasons were not, therefore, limited to changes in base rate.

Mr F's representatives referred the complaint to our service on his behalf. Nationwide didn't give our service consent to consider the complaint as they said it had been made outside of the time limits.

Jurisdiction and matters relevant to the scope of our investigation

Our service issued a decision which set out which parts of Mr F's complaint we had the power to consider. The Ombudsman decided that we could only consider Mr F's complaint about the interest Nationwide had charged on his mortgage from March 2014 onwards.

The Ombudsman also said that when considering whether the rate charged from March 2014 onwards was fair and reasonable in all the circumstances of the case, we will need to have regard to the changes made to the interest rate before March 2014 which led to the rate charged and the payments Mr F made after March 2014.

Our Investigator then went on to consider the merits of Mr F's complaint limited to the interest Nationwide charged from March 2014 onwards. Having done so, he didn't think Nationwide had acted unfairly, and he wrote to the parties explaining why.

Request for Ombudsman review

Mr F's representatives asked for the complaint to be passed to an Ombudsman for a decision. They asked the Ombudsman to consider the third party report they'd submitted which they said confirmed that the costs of funds decreased following the credit crisis. And that whilst the costs of funds is only one factor in setting interest rates, it contradicts the information Nationwide had provided.

Our Investigator responded to explain that he'd considered all of the evidence Mr F's representatives had provided, but that didn't change his opinion about whether Nationwide had acted unfairly.

Mr F's representatives still disagreed, but did not make any further substantive representations, and so the complaint's been passed to me to issue a 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.

In his provisional assessment, the Investigator set out a detailed explanation of the reasons that led him to conclude that Nationwide had acted fairly and reasonably in its dealings with Mr F. I have carefully considered the complaint and the evidence, and, having done so, I agree with and adopt the reasoning in the Investigator's provisional assessment. For ease, I've set out what he said below:

"We are required to determine complaints by reference to what is, in the ombudsman's opinion, fair and reasonable in all the circumstances of the complaint.

In considering what is fair and reasonable in all the circumstances of Mr F's complaint, I am required to take into account: relevant law and regulations; regulators' rules, guidance and standards; codes of practice; and where appropriate, what I consider to have been good industry practice at the relevant time.

When considering the complaint that Mr F's representatives have made on behalf of Mr F, I've thought carefully about everything both sides have said. Whilst I may not refer to every point Mr F's representatives and Nationwide have made, I have considered them – but I've focused on what I believe to be the crux of the complaint, and the matters that I feel are material to an overall fair outcome.

I have considered the complaint under the following headings:

- *Whether the interest rate should have tracked Bank of England base rate*
- *Whether the term allowing Nationwide to vary the BMR was unfair*
- *Whether Nationwide treated Mr F unfairly in varying the BMR in the way that it did*

In doing so, I have addressed the points Mr F's representatives have made on his behalf.

Whether the interest rate should have tracked Bank of England base rate

The margin between Bank of England base rate and the BMR

Mr F's representatives have said that he was aware of the margin between the base rate and Nationwide's BMR when this mortgage was taken out, and that he was led to believe one of the features of this mortgage was that the interest rate would track the base rate over the term.

The representative's representations about this may be viewed in two ways:

- 1. That Mr F was misled when entering the contract into believing it would track the base rate when that was not in fact the case. Any such complaint would now be out of time, and I am not satisfied that this allegation is relevant context to any of the other questions I have to answer. So I have not addressed this specific issue any further.*
- 2. That Nationwide was under a contractual obligation to charge an interest rate that tracked the base rate.*

In reviewing whether Nationwide have acted fairly since March 2014, I've considered the relevant offer document and the information Mr F was given at the time the mortgage contract was agreed.

Whilst Mr F's representatives have referred to a 'margin' between the base rate and the BMR, it is not clear whether they suggest this is set out explicitly, or rather it was something that Mr F believed would happen for other reasons. I haven't seen anything in the written information provided to Mr F that would have suggested the BMR would track the base rate during the mortgage term. The mortgage offer does state that the BMR was guaranteed to be no more than 2% above base rate. But that doesn't mean it would track base rate by the same 'margin' between the two as at the time of sale (1.74%) throughout the term of the loan. Considering the terms of the mortgage that Mr F agreed to, I'm satisfied the BMR was not a 'tracker' rate.

Mr F's representatives have also said that the terms and conditions weren't included in the offer document itself, and therefore shouldn't form part of the agreement. I understand them to suggest that the terms and conditions were not incorporated into the agreement. They've said the relevant information about how the BMR would operate should have been included in the mortgage offer.

I've considered what they've said, but I don't agree. The law doesn't require all of the terms of a contract to be set out in a single document, and there are good reasons why general terms and conditions (which apply to all of a lender's mortgages) will be in a separate document from the offer (which will be specific to the individual customer).

In addition, at the time of the application in 2008 Nationwide sent a letter to Mr F containing the offer document, and the Mortgage Terms and Conditions (2001) document, and the offer document specifically refers to the Mortgage Terms and Conditions (2001):

'We are pleased to offer you a loan on the following basis, which you must repay with interest and other fees and costs on the terms set out in this Mortgage Offer and our 'Mortgage Terms & Conditions (2001) (England and Wales)'... and any special conditions attached.'

I therefore think it's clear that both of these documents make up the contract agreed by Mr F and Nationwide, and so I'm satisfied the terms and conditions set out in the separate document apply to the mortgage.

I've also kept in mind that a mortgage represents a substantial liability for the large majority of borrowers, secured on their principal asset, and I think that – ordinarily – a borrower such as Mr F ought reasonably to be treated as if they had read all of the information provided with the mortgage offer, including the associated terms and conditions – whether or not in practice they did.

Overall, I am satisfied that Mr F entered into a contract that did not commit to track the Bank of England base rate, was made sufficiently aware of its terms, and that Nationwide has sought to charge interest in accordance with the terms of that contract.

I've explained why I'm satisfied that the terms contained within the terms and conditions document form part of the contract between Nationwide and Mr F. And that I don't agree that there's a fixed 'margin' set out in the terms in the way Mr F's representatives have identified.

However, Mr F's representatives have also (i) said that the terms setting out the circumstances in which Nationwide could make changes to the BMR charged on Mr F's mortgage were unfair as a matter of law, and (ii) raised concerns about the fairness of Nationwide's decisions to vary the BMR.

I'm satisfied that the fairness of the BMR over the entire term of the loan is a relevant consideration when assessing whether the interest rate applied to Mr F's mortgage during the period I can consider was fair. That's because since March 2014 Mr F has paid the BMR, and the interest rate Nationwide charged during that time was the product of variations it had made to the BMR over the entire term of the loan.

The BMR applied from March 2014 onwards wasn't set 'in a vacuum', but rather was the product of earlier decisions. I'm therefore satisfied that I need to consider how the BMR was varied to reach a decision about what is fair and reasonable - as I am required to do by the DISP rules - 'in all the circumstances of the case.' If there are issues with the fairness of the SVR itself, then I think that necessarily means that there may be issues with the fairness of monthly payments from March 2014 onwards made by reference to the BMR. However, if our service decides to uphold the complaint, redress can only be awarded for the period from March 2014 onwards.

I am mindful that Nationwide does not agree it is appropriate for me to consider the variations and BMR history before March 2014 when deciding what is fair and reasonable. But for the reasons set out below, I do not in any event think Nationwide acted unfairly or unreasonably in the period before March 2014 (or after), so this question does not ultimately affect my overall conclusions about what is fair and reasonable in the circumstances of this complaint.

The fairness of the interest rate terms

I've first considered the terms of the contract: (i) what they say about the rate that will apply, (ii) how Nationwide may vary the BMR, and (iii) whether there is anything inherently unfair about the terms allowing Nationwide to vary the BMR.

(i) The rates permitted by the contract

As I've previously explained, section 4 of the mortgage offer said that:

"Your loan will be on: Our Base Mortgage Rate, which is our standard variable rate, currently 6.74%, which will apply from completion for the term of your mortgage. This rate is guaranteed to be no more than 2% above the Bank of England base rate. For the purpose of this guarantee, any variation to the interest rate as a result of the change in the Bank of England base rate will take place within one month of the announcement of such change. Before or after the loan is made, we may change our Base Mortgage Rate under our Mortgage Conditions 2001. This will result in a change to your monthly payment."

When Mr F was paying the BMR, each of the changes made to that rate were made following a change, and by reference to, the base rate.

(ii) The interest rate terms – varying the BMR

Some information relating to the BMR was set out in the Mortgage Terms and Conditions (2001), a separate document to the mortgage offer. These state that:

"We may change the interest rate applicable to the debt at any time except during any fixed rate period under the mortgage offer. Any change in interest rate will be notified to you either by advertisement or by personal notice (or both) under condition 17. Any change in the interest rate will not come into effect until we have given notice of the change under condition 17."

Nationwide have provided evidence to show that each time the interest rate was changed on Mr F's mortgage, they wrote to him to tell him about the change.

In relation to changes to the interest rate, the relevant terms and conditions are set out under section 5 of the Mortgage Terms and Conditions (2001). I've set out the key parts of this section below.

5.2 We will only change the interest rate for one or more of the following reasons:

- (i) to reflect a change, or a change we expect to occur, in the cost of funds we use for our mortgage lending;
- (ii) to reflect any change in the law or decision by a court;
- (iii) to reflect a change in regulatory requirements;
- (iv) to reflect a change in the way the property is used or occupied;
- (v) to reflect a change in the credit risk relating to the loan.

(iii) Are the terms allowing Nationwide to vary the BMR unfair as a matter of law?

In my view, the law relating to unfair terms in consumer contracts is of particular relevance to this aspect of the complaint, specifically the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR).

I have set out the law in some detail, because there are a number of matters I need to consider when deciding how they apply to the facts of the present complaint.

The relevant law

Regulation 5(1) says:

*"A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of **good faith**, it causes a **significant imbalance** in the parties' rights and obligations arising under the contract, to the **detriment** of the consumer.*

Regulation 6 says:

"(1) ... the unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances

attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.

So it's important to remember that I have to consider whether the variation terms were unfair based on the situation when Mr F took the mortgage out.

(2) In so far as it is in plain intelligible language, the assessment of fairness of a term shall not relate -

- (a) To the definition of the **main subject matter** of the contract, or*
- (b) To the adequacy of the price or remuneration, as against the goods or services supplied in exchange."*

The UTCCR includes a non-exhaustive 'grey' list in Schedule 2 of example terms that may be regarded as unfair. This list includes the following example:

"1. Terms which have the object and effect of-

(j) enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract..."

However, the scope of this is limited by paragraph 2(b) of this Schedule which states:

"Paragraph 1(j) is without hindrance to terms under which a supplier of financial services reserves the right to alter the rate of interest payable by the consumer or due to the latter, or the amount of other charges for financial services without notice where there is a valid reason, provided that the supplier is required to inform the other contracting party or parties thereof at the earliest opportunity and that the latter are free to dissolve the contract immediately."

Regulation 8 of the UTCCR states the remedy that should be applied in the event a court finds a contract term unfair. It says:

- (1) An unfair term in a contract concluded with a consumer by a seller or supplier shall not be binding on the consumer.*
- (2) The contract shall continue to bind the parties if it is capable of continuing in existence without the unfair term.*

There is a body of case law from both UK courts and the Court of Justice of the European Union (CJEU) which has considered the fairness of various terms over time, although, the latter only provide general guidance as it's for the UK courts to decide if a particular term is unfair. I have referred to this below where relevant.

Main subject matter of the contract: Regulation 6(2) of the UTCCR says that any terms that relate to the main subject-matter of the contract or adequacy of the price and remuneration - these are often described as "core terms" – cannot be assessed for fairness. So if the BMR variation clause is a core term, a court could not consider whether it was unfair for the purposes of the UTCCR.

The CJEU concluded that a price variation clause in a contract is not a 'core term' in the Invitel case (Case C-472/10). It said:

"the assessment of the unfair nature of terms is to relate neither to the definition of the main subject-matter of the contract nor to the adequacy of the price and remuneration ... this exclusion cannot apply to a term relating to a mechanism for amending the prices of the services provided to the consumer."

Fairness: The leading UK judgment on the UTCCR is the 2015 Supreme Court case *ParkingEye v Beavis*. The Court noted that the test in Regulation 5(1) - of a "significant imbalance" contrary to the requirement of "good faith" - merely defines in a general way the factors which render unfair those contract terms that have not been individually negotiated.

The Court said that:

- the test for establishing a **significant imbalance** includes, but is not limited to, asking whether the terms of the agreement deprive the consumer of an advantage which they would enjoy under national law in the absence of the contractual provision;
- the question of whether a term is contrary to the requirements of **good faith** depends on an objective hypothetical negotiation, asking whether an informed consumer would have agreed to the term in question during individual contract negotiations. This should take into account a wider circumstantial review, such as the relationship with other relevant contractual terms; and
- consideration should be given to the nature of the goods or services supplied, including the significance, purpose and effect of the term in question.
- FCA guidance (FG18/07) on unfair terms in consumer contracts says that 'The fairness assessment is a holistic assessment and these two elements may overlap in the way they apply to any particular set of facts' and that the applicable law 'recognises the importance of striking a fair balance between the legitimate interests of both the supplier and consumer.' That means that the seller or supplier may be able to show they've acted in good faith where they can show they've taken the consumers' legitimate interest into account. That guidance also provides an overview of factors relevant to determining whether or not a variation term is fair.

The good faith requirement behind the test is multi-faceted, as was explained by Lord Bingham (in the context of the original 1994 Regulations) as follows:

"The requirement of good faith in this context is one of fair and open dealing. Openness requires that the terms should be expressed fully, clearly and legibly, containing no concealed pitfalls or traps. Appropriate prominence should be given to terms which might operate disadvantageously to the customer. Fair dealing requires that a supplier should not, whether deliberately or unconsciously, take advantage of the consumer's necessity, indigence, lack of experience, unfamiliarity with the subject matter of the contract, weak bargaining position or any other factor listed in or analogous to those listed in Schedule 2 to the [1994] Regulations. Good faith in this context is not an artificial or technical concept; . . . It looks to good standards of commercial morality and practice. Regulation 4(1) lays down a composite test, covering both the making and the substance of the contract, and must be applied bearing clearly in mind the objective which the Regulations are designed to promote."

Transparency: In *Kasler* (Case C- 26/13) the CJEU considered the meaning of 'plain intelligible language' in the context of terms in a loan agreement. It said that the requirement of transparency must be understood in a broad sense. A term which has the effect of increasing the cost at the consumer's expense didn't just have to be formally and

grammatically correct, but the reason for and particularities of a variation term have to be clear and intelligible. So does the term's relationship with other terms in the contract, relating to the advance of the loan. This is so the average consumer is aware of the variation term and can assess the potential economic consequences for them which might derive from it.

In RWE (Case C-92/11) the CJEU stressed that 'it is of fundamental importance for that purpose, first, whether the contract sets out in transparent fashion the reason for and method of the variation of the charges for the service to be provided, so that the consumer can foresee, on the basis of clear, intelligible criteria, the alterations that may be made to those charges.' In addition, the CJEU was concerned that the customer is provided with meaningful criteria by which they can verify, and if necessary challenge, any proposed variation to the rate.

In Matei (C-143/13) the CJEU referred to the loan agreement needing to set out 'transparently the reasons for and the particularities of the mechanism for altering the interest rate and the relationship between that mechanism and the other terms relating to the lender's remuneration, so that the consumer can foresee, on the basis of clear, intelligible criteria, the economic consequences for him which derive from it.'

So when considering whether the SVR variation clause is sufficiently transparent, I will need to consider whether it gives the customer adequate clarity on not only the reasons for the variation, but also the method used so that the customer can foresee the economic consequences of the bank's power to change the SVR and verify the basis for the change to the rate.

Barriers to exit: In RWE the CJEU placed a great deal of importance on the consumer not only having the right to terminate the contract in the event of a unilateral price variation; but actually being able to exercise this right in practice. The Financial Conduct Authority (FCA) guidance states at paragraphs 66 and 67 that firms should consider the consumer's freedom to exit the contract if they do not accept the variation, and how they can actually do so. This should include the financial and practical barriers which may prevent them from doing so within any advance notice or reasonable timeframe. Examples of barriers could be exit charges or requiring the consumer to give a long period of notice, but that this may also be practical barriers outside the contractual terms that might prevent or hinder the consumer exiting the contract within any advance notice period or reasonable timeframe.

So, when considering whether the terms give rise to a significant imbalance in the rights and obligations of the parties contrary to the requirements of good faith, I will need to consider whether and the extent to which an average consumer would foreseeably be able to exercise the right to terminate the contract in practice.

Application to the complaint

I have considered the relevance of the law relating to unfair terms to the interest rate variation term in this case. I'm satisfied that I need to address the following in deciding whether the BMR variation clause was unfair:

- Whether the term is a core term
- Whether the term creates a significant imbalance in the parties' rights and obligations to the consumer's detriment contrary to the requirement of good faith

I have reminded myself that the decision whether the term is unfair should be made in the light of what sort of contract is in issue and what the contract is about, as well as what the other terms say and all the circumstances that existed when the term was agreed. Assessing whether a term is unfair involves winding the clock back to the date the term was agreed,

and then as it were “standing back” to consider the term in its full context, both within the contract and in all the surrounding circumstances.

Core term: Properly understood, the terms relate to the mechanism for amending the price of the services provided, rather than the price itself. In *Invitel* the CJEU took a similar view. They are therefore ancillary terms whose fairness can be assessed under the applicable fair terms legislation.

So I’ve gone on to consider whether the terms create a significant imbalance in the rights and obligations of the parties contrary to the requirements of good faith.

Significant imbalance contrary to the requirements of good faith: I have reminded myself that I need to undertake a holistic (or ‘in the round’) analysis of whether the terms strike a fair balance between the legitimate interests of both the supplier and consumer. In doing so I have looked at:

- Whether the terms deprive consumers of an advantage they would enjoy under national law in the absence of the terms;
- Whether the terms go further than is reasonably necessary to protect the lender’s legitimate interests and whether the lender, dealing equitably and fairly with a consumer, could reasonably assume that the average consumer would have agreed to the term in hypothetical individual contract negotiations;
- Whether there were significant practical barriers to dissolving the agreement that may show unfairness.

I note that the FCA Guidance sets out at paragraph 41 a list of factors that may make a term unfair. I also note that the guidance says that the assessment is intensely fact-specific:

‘Subject to the general law on unfair contract terms and to proper consideration of all the relevant circumstances, we consider that the factors listed in the table are relevant when assessing the fairness of variation terms. There may be other factors to consider, and the presence or absence of one or more of the factors does not necessarily mean that a term is fair or unfair. The factors are not listed in order of importance and there is some overlap between them. The weight to be given to the factors will depend on all the circumstances relevant to the assessment of the fairness of the particular term.’

As discussed above, I need to ask whether the terms of the agreement deprive the consumer of an advantage which they would enjoy under national law if the term was not there. I’m not satisfied that an interest rate variation clause does this in and of itself. That’s because, at a general level, such clauses have a legitimate purpose. As the FCA guidance says at paragraph 34:

‘Unilateral variation terms are common in financial services consumer contracts. This is particularly the case for contracts of long or indeterminate duration, such as current account, personal pension, mortgage or credit card agreements. We acknowledge the benefit of fair variation terms to firms and consumers, because they allow contracts to be changed over their lifetime, making them more available to consumers. For example, being able to change variable-rate contracts allows firms to offer competitively-priced products that do not just track base rate, so offering consumers greater choice. This is because firms know that they can vary the interest rates they charge to reflect changes in circumstances, particularly in their own costs of funding...’

Reversion rates serve a legitimate purpose in permitting lenders to provide for future changes that justify increases in the rate, and a lender’s own costs of funds are by nature

difficult to foresee. So I'm satisfied that, if the agreement itself didn't include a rate variation clause, it's reasonable to assume that national law would provide for a mechanism allowing a lender to vary the rate for legitimate reasons. And I think the average customer could reasonably be assumed to accept this and agree to it in hypothetical negotiations.

I think the real issues are whether the terms in this agreement go further than reasonably necessary to protect Nationwide's legitimate interests, whether the BMR variation clauses are sufficiently transparent, and whether there were significant barriers to Mr F dissolving the contract.

I am satisfied that the reasons for changes at 5.2 of the terms and conditions are legitimate. The purposes are limited and appear designed to enable Nationwide to respond to changing circumstances beyond its control which may have an impact on how it runs its mortgage business. I have also noted that the terms could operate to a consumer's benefit, namely by reducing the SVR (which happened in this case), and that the terms and conditions provide for Nationwide to give notice before a change takes effect.

I'm also satisfied that the terms contained within the Mortgage Terms and Conditions (2001) document largely satisfy the wider transparency requirements. Grammatically they are easy to follow, the circumstances in which changes might be made are set out in what I consider to be adequate detail, and their effect is something that could be assessed objectively. In other words, I am satisfied that a customer could understand the underlying basis and, in broad terms, the mechanics for any decisions taken that relied on those terms, be able to understand broadly the economic consequences of entering into the agreement and, if necessary, challenge a variation made in reliance on them.

Given what I've said above about variation rates serving a legitimate purpose, I think a hypothetical consumer would have agreed to a term that enabled the lender to increase the SVR payable on their mortgage for the relatively limited reasons set out in the contract. So I do not think it is likely a court would consider the term unfair for that reason.

But I accept that it is possible that a court might conclude that the term could give further detail on the circumstances in which the rate might change, and therefore could be more transparent. For the purpose of considering whether the term is fair, I have proceeded on the basis that the term is not as transparent as it might be.

I have also considered whether – at the time the contract was taken out – there were likely to be such significant barriers to Mr F dissolving the contract that he could not effectively make use of the right to do so. That is something I need to consider both for the sake of deciding whether the term may be on the 'grey list' in Schedule 2 of the UTCCR that may be regarded as being unfair, as well as part of the wider analysis of whether the term creates a significant imbalance contrary to the requirement of good faith. If there were such barriers, that may mean that the variation terms are unfair.

I have reminded myself that – in assessing whether the term itself is unfair - the test is not whether there were significant practical barriers for Mr F at the point at which the BMR was varied, but rather whether it was foreseeable at the time the contract was entered into that there may have been such barriers.

There was no Early Repayment Charge (ERC) applicable to Mr F's mortgage. So if Nationwide had exercised their rights as set by the variation term, and Mr F was unhappy with that decision, he was free under the contract to transfer his mortgage to another lender if he wished without having to pay a charge to end the existing contract with Nationwide.

Mr F's representatives have said that other costs impacted on Mr F's ability to redeem his mortgage and transfer to another lender, and the offer sets out that if the mortgage is

redeemed there's a redemption charge due of £90. I've considered this, but I'm not satisfied that this fee was a 'significant barrier' to his (or any other consumer's) ability to redeem the loan in the way that e.g. an ERC would be. This fee would've always been due when the mortgage was redeemed, whether that was before the end of the intended term or not, and is set out clearly in the offer document.

Mr F's representatives have also said that had Mr F chosen to move his mortgage to another lender, he would have been subject to switching costs. I assume Mr F's representatives are referring here to the costs associated with taking out a new mortgage, such as application and product fees, as well as valuation fees and solicitor's costs. Whilst I agree that it is likely Mr F would have incurred these costs if he'd chosen to move his mortgage, I'm not persuaded these are the sort of significant barriers that the CJEU and FCA had in mind when determining whether a variation clause is unfair. A borrower would incur these costs if ever they sought to switch lender.

So I don't think that the variation terms would have been unfair simply because at a general level there would be a cost to a consumer from moving elsewhere.

Conclusion on fairness: I think that a court would conclude that the variation terms were not unfair and would not fall within the Schedule 2 'grey list'. Although it is arguable that the terms could be more transparent, I am satisfied that overall they do not create a significant imbalance between the parties contrary to the requirement of good faith, and that a consumer in a hypothetical negotiation would have agreed to the term. So for the purposes of this decision, I have proceeded on the basis that the variation terms I have discussed above are not unfair as a matter of law.

If I am wrong about that, I've reminded myself that legally, the effect of a term being unfair is that it won't apply. But that wouldn't necessarily mean that there has been unfairness. Our service is required to consider what is fair and reasonable in all the circumstances. That includes – but is not limited to – relevant law.

So while I have taken account of the relevant law regarding unfair contractual terms, I've also thought more broadly about whether, and the extent to which, the way in which the terms have been used has resulted in unfair treatment for Mr F. I think that is the ultimate question I need to answer in deciding whether to uphold the complaint.

Have Nationwide exercised the terms fairly?

Mr F's representatives have said that there is an implied term that a party such as Mr F contracting with a seller or supplier such as Nationwide will pay a reasonable charge. And for the reasons I've given above, I don't think it's realistic to expect a reversion rate to remain static over a period of 20-30 years.

I think that it is necessary to consider what – if any – unfairness Mr F suffered as a result of mortgage payments based on changes to his interest rate. And that requires me to consider whether Nationwide have exercised the terms fairly. So I've considered (i) whether I think Nationwide had legitimate reasons for varying the rate in the way it did, and (ii) the impact on Mr F.

I'm not satisfied that there is anything inherently unfair about a mortgage remaining on a reversionary variable rate. They serve a legitimate purpose in permitting lenders to provide for future changes that justify changes in the rate, where costs to them are variable. Some borrowers choose to pay the reversionary variable rate on their mortgage as a result of the flexibility it offers as, in this case, whilst it's the rate payable on the mortgage, borrowers are usually free to shop around without incurring an ERC.

So, I've thought about why Nationwide made changes to their BMR, and more broadly whether there is anything unfair about the rate Mr F has paid.

I've already explained that our service only has the power to consider the complaint points Mr F's representatives have raised from the period March 2014 onwards. But my investigation into the complaint needs to consider all the circumstances relevant to the case. That includes the changes made to the BMR over the entire term of the mortgage. As these are relevant to my investigation into the parts of the complaint I can consider. Having done so, I'm not persuaded Nationwide have varied the rate unfairly. I'll explain why.

Since Mr F took out his mortgage and started paying the BMR, the rate only reduced until base rate increased in 2017. Throughout the entire term of the mortgage, the BMR remained within the 2% cap above the base rate, as set out in the terms.

However, the 'margin' between the BMR and base rate did increase from 1.74% (when the mortgage was agreed in 2008) to 2% in January 2009. During this period it was a time of significant change in the wider market as a result of the financial crisis. This impacted on the funding costs of businesses and was reflected in changes to a number of lenders' interest rates charged across the market at the time.

Nationwide have explained to our service how they made the decision to reduce their BMR by the amount they did, and the sorts of factors they took into account. The detailed information they have given us about that is commercially sensitive, and so it's something that I think it's reasonable for our service to consider in confidence. But, I have summarised their submissions briefly below (as the dispute resolution rules (DISP) permit me to do):

- *The reductions in the base rate did not reduce Nationwide's cost of funding to the same degree. Nationwide's cost of funding is dependent on a range of factors. Whilst they do include base rate changes, they are also significantly influenced by the mix of funding raised, the market's perceived creditworthiness of Nationwide, and the supply of and demand for deposits across the industry.*
- *The factors driving the difference between the base rate and Nationwide's cost of funds will have included an increase in competition for customer deposits across the industry, and an increase in the relative cost of raising wholesale funding (which will have been influenced by factors such as the perception of an increased risk of defaults on funding issued).*
- *During the period 2008-2010, Nationwide's relative cost of funds rose by more than the change in 'margin' difference between the BMR and the base rate. But they kept the cap in place, which meant that the interest rate applied to Mr F's account still reduced significantly.*

I'm also mindful that the FCA have noted the adverse impact the financial crisis had on lender's costs during that period, and that they've not seen that SVR variation terms have generally been relied on unfairly to cause widespread detriment to consumers (see for example the May 2018 Guidance Consultation GC18/2 Fairness of Variation terms in financial services consumer contracts under the Consumer Rights Act 2015 paragraphs 2.8 to 2.10)

Whilst the base rate did reduce significantly during this period, the costs to lenders of funding their business changed, as did their prudential requirements. These are made up of several factors that are not directly linked to base rate. There was a substantial increase in risk to all lenders during that period, and that led to them having to mitigate that risk in

different ways. So I think there are likely to be objectively justifiable reasons why Nationwide did not reduce the applicable rate at the same level as the reduction in Bank of England base rate.

It's not uncommon for lenders to make changes to their variable rates when the base rate changes because of the effects those changes have on the market generally. But as I've said, that's only one factor that impacts the funding costs and prudential stability of lenders in the market. The base rate reduced, and so did Nationwide's BMR, but just not by the same proportion. Considering everything, I'm persuaded the changes made during this time were reasonable, and I've not seen anything to suggest that Nationwide acted in an arbitrary or unfair way as alleged in Mr F's complaint letter.

So whilst the reductions during this period didn't mirror reductions to the base rate, I don't think the terms or general requirements of fairness obliged Nationwide to make the reductions in that particular way. And I don't think, taking into account all the circumstances in the round, that these changes resulted in unfair treatment for Mr F or that Nationwide acted in a way other than to protect its legitimate interests.

For the remainder of the term, until the complaint was made, the only changes Nationwide made to the BMR were made soon after changes were made to the base rate, and by the same amount. Nationwide have explained that during periods of economic calm, overall cost of funding approximately follows changes to the base rate. As opposed to what happens during periods of market volatility and general economic uncertainty, when an increasing divergence between base rate and funding costs occurs. I'm also mindful that from 2014, the interest rate charged on Mr F's mortgage acted in the way he believed it would – by tracking movements in the base rate.

Overall taking into account all of the changes made to the BMR, while the terms do provide Nationwide with discretion in regards to when or whether to vary the BMR charged on Mr F's mortgage this is for legitimate reasons, and I don't think there is anything to suggest that Nationwide has acted unfairly or unreasonably, or that Mr F has overpaid interest as he claims.

Whilst it's not ultimately of significance to the outcome of the complaint, I also note that the rate Mr F has paid is one of the lowest reversionary rates on the market and is clearly not an obvious outlier or manifestly excessive. Indeed – were it not for the 2% cap margin – the evidence in this cases suggests that Nationwide could reasonably have reduced the rate by less than it did, increasing the margin further, in the period after the financial crisis in 2008/2009."

The Investigator also commented on Mr F's representatives' response to the provisional assessment. So far as it is relevant, he said:

"Before I reached my view, I took into account all the information that had been provided by both parties. That included the report provided by [Mr F's representative] that you've referred to. Whilst the report contains a helpful discussion about the operation of standard variable rates (SVRs) more generally, it did not contain any specific evidence or information that demonstrated the BMR Mr F has paid was set unfairly.

Nationwide provided us with information about how their specific costs of funds have varied over time, and the impact this had on their decision to set the BMR at the level they did. Having reviewed all the information provided, I was satisfied that Nationwide's costs of funds did not reduce by the same proportion that the base rate reduced following the financial crisis. The base rate is only one factor that influences the costs to lenders of operating their mortgage business. As I said in my view, Nationwide's relative cost of funds rose by more than the change in 'margin' difference between the BMR and the base rate. But they kept the

cap in place, which meant that the interest rate applied to Mr F's account still reduced significantly.

Although it does not ultimately affect my conclusions about what is fair and reasonable and the reasons for those conclusions which I set out in my assessment letter, I note that one of the policy recommendations the report suggests is for there to be a limit on how high an SVR can go above the base rate (and gives the example of 2%). That is in fact the way the interest rate Mr F paid on his mortgage did operate – as it was kept within a 2% cap. From the point Mr F agreed to the mortgage and the interest rate, the margin between the interest rate he paid and the base rate only increased by 0.26%. Mr F remained on an extremely competitive rate when compared to others in the market, and for all the reasons I set out in my provisional assessment I'm not persuaded he's been treated unfairly."

My findings

As I've explained I have carefully considered all of the evidence and arguments to decide what is fair and reasonable in all the circumstances of this case and, having done so, I have reached the same conclusions as the Investigator and for the same reasons, which I adopt.

In summary, like the Investigator, I am satisfied that a court would be unlikely to conclude that the variation terms are unfair as a matter of law. But even if the terms were unfair that wouldn't necessarily mean that there has been unfairness. I am required to decide what is fair and reasonable in all the circumstances – that includes, but is not limited to, taking into account relevant law.

And I also agree with the Investigator that the central question I need to consider when deciding whether Nationwide treated Mr F fairly and reasonably, is how Nationwide actually used the term, and whether that resulted in unfair treatment for Mr F.

Considering all the evidence and for the reasons set out by the Investigator, I'm not persuaded that Nationwide has varied the rate unfairly resulting in the unfair treatment of Mr F in the period since March 2014, or that Mr F has overpaid interest as he claims.

Whilst the margin between the BMR and the base rate did increase slightly from the time Mr F agreed to the mortgage, I'm satisfied that Nationwide increased that margin for objectively justifiable reasons and I am not persuaded that the changes made to the rate then or since resulted in unfair treatment for Mr F. And as the Investigator said, the evidence suggests that Nationwide could fairly have increased that margin further if it hadn't been for the 2% cap.

I appreciate Mr F's representatives disagree with that view, and in doing so have relied on a report they provided to our service which they say is evidence that costs of funds decreased at the time when Nationwide increased the margin between their BMR and base rate. But whilst I've carefully considered the contents of that report (which provides comment and opinion on SVRs generally in the industry, rather than Nationwide's specifically), I have to weigh that up against the case specific information I've received from both sides. And in this case, the contents of that report have not changed my mind about whether Nationwide treated Mr F fairly.

Overall, having carefully considered all the information and evidence, I am not persuaded that Nationwide has acted unfairly or unreasonably in its dealings with Mr F, and it has not charged Mr F interest on his mortgage unfairly.

My final decision

Considering everything, for the reasons I've explained, I don't uphold this complaint and I make no award.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr F to accept or

reject my decision before 5 August 2022.

Kathryn Billings
Ombudsman