DRN-3592245

The complaint

Ms G complains that Kensington Mortgage Company Limited wouldn't offer her a new interest rate on her mortgage, or allow her to convert it back to repayment terms.

What happened

Ms G has a mortgage with Kensington. In 2005 she borrowed around £110,000 over a 25 year term, initially on repayment terms, though she later converted the mortgage to interest only. The mortgage was on Kensington's variable rate (the KVR) plus a 0.69% premium, capped to 6.34%, until November 2008. From then on, it was on the KVR plus 1.3% with no cap.

The mortgage terms and conditions say that the KVR is a variable rate, but will always be at least 1%, but no more than 3%, above LIBOR. This means that Ms G's mortgage does not track the LIBOR rate directly, but her interest rate has been between 2.3% and 4.3% above LIBOR from 1 December 2008.

In June 2020, she asked Kensington for a new lower interest rate. She says that she was finding it difficult to manage the payments (though was not in arrears) and rather than take a coronavirus payment deferral, she would rather reduce the interest rate if possible.

Kensington said it had no new rates available to Ms G. It recommended Ms G seek independent financial advice to explore moving her mortgage elsewhere or taking a new mortgage with Kensington. Ms G wasn't happy with this, so she complained. She also wants Kensington to convert the mortgage back to repayment terms, as she's concerned she has no means of repaying the capital at the end of the term if it stays on interest only.

Later, in October 2020, Kensington wrote to Ms G saying that it could not offer her a new rate but that she might want to explore whether she could move her mortgage to another lender, and pointed her to sources of independent mortgage advice.

In November 2020, Ms G called Kensington to ask about converting the mortgage from interest only to repayment. She also asked again about a new interest rate. Kensington's notes record that it told her she would have to make an application to convert the mortgage to repayment, and that it couldn't offer a new interest rate.

In October 2021, Kensington wrote to Ms G inviting her to take a new interest rate. It offered a variable rate of 3.99% above the Kensington Standard Rate (KSR), which was in turn linked to the Bank of England base rate. As base rate was 0.1% at the time, Kensington offered Ms G a variable rate of 4.09%. Ms G did not accept that offer.

In March 2022, Kensington transferred the mortgage to another lender.

Ms G complained to us. She said her current interest rate was 4.5% and she was finding it difficult to maintain the payments. She wanted Kensington to offer her a lower interest rate.

Our investigator said Ms G's complaint should be upheld. He said Kensington should have offered Ms G a new interest rate when she asked for one in June 2020. Kensington did not agree, so the complaint comes to me for a decision to be made.

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.

I'm sorry to hear of the health and other difficulties Ms G has faced in recent years.

I've looked carefully at what has happened here to decide whether I think Kensington has treated her fairly.

The first thing to say is that applying for a new interest rate is separate to converting the mortgage back to repayment terms.

When Ms G discussed converting the mortgage with Kensington in November 2020, it didn't say this wasn't possible – it said Ms G would need to make a formal application so that Kensington could check whether this was appropriate for her.

I think this was reasonable. I understand why Ms G wanted to convert the mortgage back – not least because she's concerned that she otherwise doesn't have a way of repaying the capital at the end of the term. And so it's sensible that she wanted to switch to repayment terms to avoid this problem. But moving the mortgage to repayment means that Ms G would have to pay a portion of the capital each month as well as the interest.

This would substantially increase her monthly payments. And therefore it's reasonable for Kensington to want to make sure this is affordable for her before committing her to those higher payments. This is why an application was necessary – so that Ms G could provide full information about her circumstances and Kensington could make an assessment. I don't think Kensington treated her unfairly in saying that a full application would be needed.

Ms G's mortgage has now been moved to a new lender. She's recently told our investigator that increases in interest rates have made things more difficult for her so it may be that she's no longer in a position to convert the mortgage to repayment terms. But if this is something she still wants to do, it may be something she can discuss with the new lender.

Ms G also doesn't think it's fair that the mortgage has been moved. But this is something Kensington is allowed to do under the terms and conditions. So I don't think I can fairly find that it wasn't entitled to move the mortgage to the new lender.

I'll turn now to the question of the interest rate. Ms G's mortgage has been on the KVR, plus a premium, since the start. This is what the mortgage offer says would happen, and therefore the mortgage has operated as it always should have done.

More recently, Ms G asked Kensington to reduce her interest rate. There's no obligation on a lender to offer new rates to its customers – and, until 2017, Kensington didn't do so.

But in 2017 Kensington started offering new fixed interest rates to some – though not all – customers. In general, it's willing to offer new fixed rates (subject to other criteria) to customers whose mortgages were taken out since 2010 – but not to customers with older mortgages.

This is because, as part of its business model, Kensington securitises its mortgages. This means it offers the beneficial interest in groups of loans to third party investors to raise funds for its ongoing mortgage business. This is a normal and legitimate feature of the mortgage industry and it’s not inherently unfair that Kensington operates its business in this way.

Kensington says that one consequence of this is that customers whose mortgages were taken out before 2010 – when lending standards were very different to those of today – can not be offered new interest rates. That’s because changes to their existing mortgages can’t be made under the terms of the securitisations. And because the loans were originally lent under less strict lending standards, it can’t move them to new securitisations either.

Customers in Ms G’s position therefore must remain on their existing interest rate, move their mortgage to another lender, or re-apply to Kensington as a new borrower and take a new mortgage to replace the old one.

Ms G wasn’t in a position to move to another lender. She has an interest only mortgage with no repayment strategy. Given what she’s told us about her financial and other circumstances I think it’s unlikely she would have been in a position to successfully apply to another lender for a mortgage on repayment terms. This means she had no option but to remain with Kensington.

I’ve said that there’s no obligation on a lender to offer new interest rates to its customers. Before 2017, when Kensington had no rates available at all, Ms G was in the same position as all other customers and it therefore wasn’t unfair that no rates were available to her.

However, when she asked Kensington about changing her interest rate in June 2020, things had changed. By then, Kensington did offer rates to some new customers. So I need to decide whether it was fair that it still didn’t make any available to Ms G.

In thinking about this, I’ve taken into account the rules of mortgage regulation, to be found in the Financial Conduct Authority (FCA) Handbook under the heading MCOB.

In particular, MCOB 11.8.1 E (the E means it’s an evidential provision, not a rule) says that where a borrower is unable to move their mortgage to a new lender (as Ms G was), their existing lender

> *should not (for example, by offering less favourable interest rates or other terms) take advantage of the customer’s situation or treat the customer any less favourably than it would treat other customers with similar characteristics. To do so may be relied on as tending to show contravention of Principle 6 (Customer’s interests).*

Principle 6 is another part of the FCA Handbook, and says that a firm

> *must pay due regard to the interests of its customers and treat them fairly.*

As MCOB 11.8.1 E is an evidential provision, it means that conduct of the sort set out in the provision might show unfairness in some circumstances – but equally in other circumstances it might not. In my view, the provision is aimed at ensuring that borrowers who cannot shop around for a better deal are not taken advantage of and treated less favourably than other borrowers who can do so.

At the time Ms G asked about a rate, Kensington would offer a new interest rate to a customer whose loan was taken out after 2010, who had an acceptable loan to value (at the time, below 85%), and who met the following criteria:

- Not currently in arrears.

- No arrears equivalent to one month's payment or more in the last twelve months.
- No other amounts outstanding.

Kensington doesn't think MCOB 11.8.1 E applies in this situation, because it doesn't think Ms G has "similar characteristics" to customers to whom it does offer a rate – because of the circumstances in which, and when, their mortgages were taken out. It points out that the underwriting requirements were very different and that more recent customers had to meet the standards now in place before getting a mortgage, whereas Ms G did not. And for the same reasons as she can't move her mortgage to another lender, she wouldn't meet the standards now in place with Kensington.

I've taken this into account. But I don't think this is a relevant consideration. I think what's required for the purposes of MCOB 11.8.1 E is a comparison of characteristics as they are at the time of the application – in other words, did Ms G have similar characteristics, in June 2020, to customers who would have been offered a rate?

I say that because I don't think Ms G's circumstances fifteen years earlier, or Kensington's lending criteria at that time, are relevant to her situation in 2020. I think the provision is referring to characteristics at the time of the comparison.

And I also note that borrowers' circumstances can change over time, after their loans have been taken out. A customer who took out a mortgage in (say) 2015, who passed Kensington's lending criteria at the time of application but whose circumstances have since changed such that they would no longer pass those criteria in 2020 would still have been offered a rate in 2020 as long as they were not in arrears. Whereas Ms G would not.

What's relevant is whether, at the time of her application, Ms G had similar characteristics to other borrowers who would be eligible for a new interest rate – and whether, if she did, refusing her a rate would tend to show unfairness of the sort envisaged by MCOB 11.8.1 E.

I've also taken into account Kensington's reasons for using the date the mortgage was taken out as a reason to refuse a new interest rate. As I've said, that's based on its business model of securitisation. Securitisation is not an unusual business model and not inherently unfair.

However, it's also relevant to note that this is not something Ms G was aware of or had any control over. And I don't think it can be said to amount to a characteristic of Ms G or her mortgage – it's something done to her mortgage by Kensington. I don't therefore think that it's a relevant consideration for the purposes of the comparison envisaged by MCOB 11.8.1 E. It's a matter for Kensington's commercial judgement how it chooses to structure its business. But if – as I think is the case here – that potentially results in unfairness in an individual case, that's a matter for me.

We've asked Kensington to provide a full history of Ms G's mortgage but it hasn't done so. It's just provided a partial set of statements. Based on those statements, I've reconstructed as best I can Ms G's payment history.

From that, I can see that Ms G missed three monthly payments in 2018, though as she overpaid in other months it wasn't until January 2019, when she made a partial payment, that her mortgage was in arrears of more than one month's payment. As she then underpaid for the next few months (other than February 2019), the arrears reached the equivalent of between two and three months' payments by April. From May onwards, Ms G then overpaid each month and by paying a lump sum in August 2019 she cleared the remaining arrears. Thereafter she continued to overpay slightly each month and the mortgage moved into credit.

I've said that I don't think the date Ms G took out her mortgage is a characteristic for the purposes of the comparison envisaged by MCOB 11.8.1 E. Nor is the fact that Kensington has securitised her mortgage in a particular way. What's relevant are Ms G's characteristics at the time she asked to reduce her interest rate.

I think, acting fairly, at that time Kensington ought to have recognised MCOB 11.8.1 E might be relevant to her circumstances and enquired into them more carefully. Had it done so, it would have recognised that – as I've found above – it's unlikely Ms G would have been able to move her mortgage to another lender, which does bring her within the scope of MCOB 11.8.1 E.

At this time, Ms G wouldn't have been eligible for a new interest rate regardless of the date her mortgage was taken out – this is because she was in arrears until August 2019, which was less than twelve months earlier

That being the case, she wouldn't have met Kensington's lending criteria. The criteria require there to have been no arrears in the twelve months leading up to an application. In June 2020, Ms G had only been clear of arrears for ten months. She had also made a couple of payments one or two days late in the early part of 2020, but I don't think that's sufficient to fairly amount to arrears taking her outside the eligibility criteria. But she was outside the criteria because she had had arrears within the last year.

However, acting fairly and taking into account MCOB 11.8.1 E, I think that rather than telling Ms G there was no interest rate available to her at all, Kensington ought to have considered her circumstances and understood she was unable to move to another lender and shop around for a better rate. It ought to have gone on to understand that this would make MCOB 11.8.1 E relevant to her situation and that it may well have been unfair to refuse her a rate simply based on when her mortgage was taken out, when that wouldn't be a barrier to other borrowers who had similar characteristics to her at the time of this application.

Acting fairly, and taking all this into account, I think Kensington ought fairly to have told Ms G that she would be free of arrears for a year in two months' time – in August 2020. And it ought to have understood, acting fairly, that not offering her a rate no less favourable than it would offer to other customers with similar characteristics wouldn't be the fair thing to do> it follows that to avoid that unfairness, Kensington ought to have told her it would make a rate available to her once she was out of arrears for a year. Had it told her that, and if as a result Ms G had re-applied in August 2020, then I think acting fairly Kensington ought to have offered her a new rate not less favourable than it would have offered to other similar borrowers at that point.

I say that because to do otherwise would mean that she was being treated less favourably than other customers with similar characteristics – which tends to show unfairness in line with MCOB 11.8.1.

In the alternative, if because of its securitisation model Kensington didn't think it could offer Ms G a rate switch on her existing mortgage, it could have offered her a new mortgage to replace it. Although Ms G wouldn't have passed the lending criteria of a new lender, as her existing lender Kensington could have set aside an affordability assessment and an assessment of her interest only repayment strategy using MCOB 11.6.3 R and 11.7.3 R. Doing so to reduce her interest rate would in my view have been in Ms G's best interests.

Kensington says these provisions are not mandatory and it has chosen not to make use of them. And I've taken that into account. But while neither 11.6.3 R nor 11.7.3 R say that a lender *has* to make use of those rules when considering an application I think I can nevertheless take into account their availability when looking at the wider question of whether Ms G was treated fairly. Just because there is no obligation to do something, it does not follow that it must always be fair to decline to do it.

Taking all that into account, I think Kensington ought fairly to have noted that Ms G was unable to move to another lender and shop around for a better rate. I think it ought to have noted that under its existing customer rate switch criteria – setting aside point of origin, which I've explained I don't think is fair to include as a characteristic for the MCOB 11.8.1 E comparison – Ms G would have been eligible for an existing customer rate switch in two months' time. And that, in the alternative, it could have offered her a new mortgage to replace the existing one using MCOB 11.6.3 R and 11.7.3 R if it considered that its business model was a barrier to a simple rate switch.

Had it treated Ms G fairly, therefore, I think she would have been made aware that she could apply for a rate switch – or a new mortgage to replace this one – in August 2020. And if Kensington had made her aware of this, I think Ms G would have made that application – and, acting fairly, Kensington should reasonably have granted it.

Putting things right

In order to put things right, therefore, I think Kensington should put Ms G back in the position she would have been in had it done that.

Kensington should therefore send Ms G the list of rates it had available to existing customers in August 2020 with her loan to value at that time for her to select from. Once Ms G has selected a rate, it should re-calculate Ms G's mortgage as if the selected rate had been in place from 1 October 2020.

This is complicated by the fact that Kensington is no longer the owner of Ms G's mortgage. If the rate Ms G selects is a two year rate, which would have expired in October 2022, it is straightforward for Kensington to calculate the amount Ms G has overpaid between October 2020 and October 2022 and refund that amount to her directly.

But if Ms G selects a rate for a longer period, which would still be in place now, Kensington will need to refund what she has overpaid to date to her directly. And it will need to ensure that she does not pay more than she should have done for the remainder of the rate period.

It can do this either by coming to an arrangement with the new lender – by which the new lender agrees to reduce the interest rate to that of the fixed rate Ms G selects, or by which the mortgage is returned to Kensington so it can change the interest rate. Or if no agreement can be reached with the new lender, Kensington could compensate Ms G for the additional amount she will pay to the new lender each month until the end of the fixed rate term. There may be other ways to resolve this too; it is for Kensington to find a way to give effect to my decision.

Finally, I think Kensington should compensate Ms G for the upset and inconvenience caused in refusing to consider changing her interest rate, which has resulted in her having to pay more each month than she would otherwise have needed to for the last two years. I'm satisfied £400 is fair in all the circumstances.

My final decision

For the reasons I've given, my final decision is that I uphold this complaint and direct Kensington Mortgage Company Limited to:

- Send Ms G the list of retention fixed rates available at her loan to value in August 2020 within 28 days of the date we notify it Ms G has accepted this decision (if she does);

- Provided Ms G selects a rate from that list and notifies Kensington Mortgage Company Limited of her selection within 28 days of being provided with the list, Kensington Mortgage Company Limited should:

    - Calculate the contractual monthly payment as it would have been on the selected interest rate if it had been put in place from 1 October 2020;

    - For each month between then and the date of calculation (or to the expiry of the selected rate if sooner), calculate the difference between the contractual monthly payment as it would have been and the contractual monthly payment as Ms G was actually charged at the time;

    - For any month in which Ms G paid at least the amount of the revised contractual monthly payment, pay Ms G the difference between the revised contractual monthly payment and the lower of the amount she actually paid or the contractual monthly payment charged at the time;

    - Add simple annual interest of 8% running from the date of each refunded monthly overpayment to the date payment is made to Ms G;

    - If the selected interest rate would have continued past the date of calculation, make arrangements to ensure that either:

        - Ms G is only charged the revised contractual monthly payment until the date the selected rate would have ended; or

        - Ms G is compensated, month by month, for the difference between the amount of the revised contractual monthly payment and the amount the new lender requires her to pay, until the date the selected rate would have ended.

- Pay Ms G £400 compensation.

Under the rules of the Financial Ombudsman Service, I’m required to ask Ms G to accept or reject my decision before 10 April 2023.

Simon Pugh
Ombudsman