DRN-3894945

## The complaint

Mr and Mrs R, represented by their solicitors, complain that NRAM Limited treated them unfairly by overcharging them on their mortgage.

## Background to the complaint

In 2006, Mr and Mrs R took out an interest only mortgage with Northern Rock Plc (now trading as NRAM Limited). At the same time, Mr and Mrs R took out an unsecured loan which was linked with the mortgage.

In 2007, Mr and Mrs R undertook a mortgage review with Northern Rock and switched their mortgage from interest only, to a repayment model. Northern Rock issued a mortgage offer on 14 August 2007 which Mr and Mrs R accepted. The offer confirmed an initial rate of 6.55% would apply to the mortgage until 1 February 2009, after which, a variable rate guaranteed to be below the standard variable rate (SVR) would apply – the Guaranteed Rate. The terms governing the unsecured loan remained the same.

During the 2008 financial crisis, Northern Rock was nationalised to avoid collapse of the bank. NRAM was later formed to manage most of the remaining Northern Rock mortgages, which included Mr and Mrs R's mortgage, where it remained until it and the unsecured loan were redeemed in March 2019. For ease, I shall refer to NRAM for the remainder of this decision.

Since Mr and Mrs R's mortgage was taken out, the Bank of England Base Rate and the Guaranteed Rate have operated as follows:

| Effective Date | Base Rate | SVR | Difference |
|---|---|---|---|
| 14/08/2007 | 5.75% | 6.55%* | |
| 01/08/2007 | | 7.84% | 2.09% |
| 06/12/2007 | 5.50% | | |
| 01/01/2008 | | 7.69% | 2.19% |
| 07/02/2008 | 5.25% | | |
| 01/03/2008 | | 7.59% | 2.34% |
| 10/04/2008 | 5% | | |
| 01/05/2008 | | 7.49% | 2.49% |
| 08/10/2008 | 4.50% | | |
| 01/11/2008 | | 7.34% | 2.84% |
| 06/11/2008 | 3% | | |
| 01/12/2008 | | 5.84% | 2.84% |
| 04/12/2008 | 2% | | |
| 01/01/2009 | | 5.34% | 3.34% |
| 08/01/2009 | 1.50% | | |
| 01/02/2009 | | 5.09%** | 3.59% |
| 05/02/2009 | 1% | | |
| 01/03/2009 | | 4.79% | 3.79% |
| 05/03/2009 | 0.50% | | |
| 01/04/2009 | | 4.79% | 4.29% |
| 04/08/2016 | 0.25% | | |

| | | | |
|---|---|---|---|
| 01/09/2016 | | 4.54% | 4.29% |
| 02/11/2017 | 0.50% | | |
| 01/01/2018 | | 4.79% | 4.29% |
| 02/08/2018 | 0.75% | | |
| 01/10/2018 | | 5.04% | 4.29% |

* Fixed rate begins
** Fixed rate ends

On 1 May 2020, Mr and Mrs R's representatives sent a letter of complaint to NRAM on Mr and Mrs R's behalf. The letter set out that Mr and Mrs R sought to claim damages in relation to being overcharged interest on their outstanding mortgage balance due to the "unlawful interest rates" and any variations in the interest rates charged by NRAM, formerly Northern Rock Plc.

The letter set out that Mr and Mrs R consider that the mortgage offer issued on 14 August 2007 contained unfair terms pursuant to the Unfair Terms in Consumer Contracts Regulations 1999 ("UTCCR"). Elaborating on this point, Mr and Mrs R's representatives argued:

- Section four of the offer letter is unfair as the term within did not explain what was meant by the "Standard Variable Rate", and Mr and Mrs R were misled into believing that this rate would vary in accordance with the Bank of England Base Rate, rather than at NRAM's discretion.
- Mr and Mrs R do not accept that the mortgage general terms and conditions, which defined the "Standard Variable Rate" were incorporated into the contract.
- It is unfair to expect a consumer, such as Mr and Mrs R, to "pore over the small print" to understand the meaning of a key term like the interest rate.
- The meaning of the "Standard Variable Rate" and particularly the fact that NRAM could vary it at its discretion, should have been set out in the mortgage offer. The failure to do so, renders the term within section four of the mortgage offer unfair for the purposes of UTCCR such that NRAM is unable to rely on it.
- A term included within a contract allowing a lender to vary interest rates entirely at its own discretion without providing grounds to do so is unfair.
- The term lacks transparency and Mr and Mrs R did not have an effective right to termination due to the presence of an Early Repayment Charge (ERC), as well as other costs associated with discharging their mortgage and switching to another lender.
- Section 15 of The Supply of Goods and Services Act should be deemed to apply in this case. This allows for the consideration of a 'reasonable rate' being applied to Mr and Mrs R's mortgage balance rather than NRAM's Guaranteed Rate.
- NRAM's actions constitute a breach of Principle 6 of the FCA Handbook whereby a firm must pay due regard to the interests of its customers and treat them fairly. And a breach of MCOB 11.5(1)(b) which requires a firm to treat customers fairly by assessing, before deciding to vary a regulated mortgage contract or home purchase plan; whether the consumer will be able to repay the sums borrowed and interest.
- Mr and Mrs R seek to claim the difference between the amount of interest they paid on their mortgage and the amount they would have paid had it been subject to what they deem to be a reasonable rate.

NRAM responded to the initial letter of complaint on 7 May 2020, disagreeing with Mr and Mrs R's allegations. In summary, NRAM argued:

- There is no evidence to support the assertion that Mr and Mrs R were misled into thinking the Standard Variable Rate ("SVR") would track base rate.
- The SVR is "clearly" described in the contractual documentation which it finds does form part of the mortgage agreement. It considers the suggestion that Mr and Mrs R ought not to be expected to read the small print pertaining to their mortgage to be misconceived.
- It is standard industry practice to place details about the variation of the SVR in the terms and conditions rather than the offer letter.

Before referring the complaint to this service, Mr and Mrs R's representative chose to write to NRAM again, further detailing the complaint as follows:

- It considers both a court and this service would find that a term allowing NRAM unilateral and unfettered ability to vary an SVR would be deemed as an unfair contract term within the scope of UTCCR.
- The interest variation terms lack transparency as required by EU law.
- While the mortgage contract provides a list of criteria upon which the SVR may be varied, the reasons given are general and vague. They do not provide the clear and intelligible criteria that would permit the average consumer to foresee how the interest rate might change in the future, resulting in the term being deemed unfair.
- The terms are not drafted in plain and intelligible language.
- As a result of the variation term being deemed unfair, it would be unenforceable under UTCCR. Relying on case law, the representative considers it would be open to a UK court to imply a term under English Law requiring payment of a reasonable rate in place of the SVR that was applied.
- It argues that a reasonable price for the SVR rate will most likely correspond to the cost of funds applicable to Mr and Mrs R's borrowing alone.

Mr and Mrs R's representative referred their complaint to our service a few days after dating the above letter.

To address the points made, NRAM chose to issue a further response on 10 November 2020. It argues that the relevant term is not unfair for the purposes of UTCCR for several reasons which I have summarised:

- The setting of the interest rate and payment of interest constitute essential obligations under the mortgage agreement, so it is doubtful that the term can be subject to an assessment of fairness as per Regulation 6(2) of the UTCCR.
- The term does not cause a significant imbalance in the parties' rights and obligations, to the detriment of Mr and Mrs R, contrary to the requirement of good faith. Instead, the term seeks to balance the rights and obligations of the parties. It highlighted Mr and Mrs R were guaranteed a fixed rate for approximately 18 months. After which, NRAM was obligated to set the variable rate below the SVR, only permitted to increase the SVR for five permitted reasons and obligated to give advance notice of any proposed change, before such change takes effect so as to give the clients an opportunity to consider their position.
- The inclusion of the term in the mortgage agreement was both substantively and procedurally fair.
- The mortgage term was transparent as it set out the reasons for any variations in

condition 7.2 of the general conditions and that prior notice would be given under condition 7.3. Furthermore, the mortgage offer set out the consequences of increases to interest rates to enable Mr and Mrs R to foresee the impact of variations in the applicable interest rate.

- The suggestion that Mr and Mrs R had no effective right of termination is misplaced. The ERC was not applicable when they were on the Guaranteed Rate and the "modest" discharge fee applicable should Mr and Mrs R have chosen to redeem their mortgage after 1 February 2009 (when the fixed period ended) was not sufficient to render Mr and Mrs R's right to termination ineffective.
- NRAM has complied with Principle 6 of the FCA Handbook at all times and has always acted in accordance with the mortgage terms and conditions. It considers its conduct to have been fair and reasonable.
- NRAM disputes that MCOB 11.5(1)(b) is engaged in this case.

In addition to its decision not to uphold Mr and Mrs R's complaint, NRAM used this letter to set out that it did not consider this service had the power to consider the complaint. It raised two key grounds for this objection:

- The setting or variation of interest rates under a mortgage contract is not an activity that is included within the scope of the ombudsman's compulsory jurisdiction.
- Even if the acts or omissions about which Mr and Mrs R complain did relate to activities to which our compulsory jurisdiction applies, the complaint has been made too late pursuant to the time limits set out in DISP 2.8.2(R) and Mr and Mrs R have not provided any reason to suggest the delay in bringing the complaint was the result of exceptional circumstances.

One of our investigators reviewed the complaint and issued an assessment concluding that this service could look at part of Mr and Mrs R's complaint. In summary, he said:

- The complaint point that, at the point of sale, Mr and Mrs R were misled into believing the SVR would track base rate had not been brought in time, under DISP 2.8.2(R).
- The complaint about how NRAM set and varied its SVR was an activity we could look at. The investigator thought that this complaint relates to acts or omissions carried on by NRAM and its predecessors in carrying on the specified activity of lending money secured by a charge on land. Providing information about the mortgage product at the outset and setting interest rates is an integral part of that activity. The investigator set out that if he was wrong about this, he was satisfied the activities could be viewed as an ancillary activity covered by our jurisdiction (DISP 2.3).
- While he was satisfied the activity complained about was something we could consider, the investigator noted he still needed to consider whether Mr and Mrs R had raised this part of their complaint in time pursuant to DISP 2.8.2(R).
- The complaint was raised on 1 May 2020, so the investigator concluded that a complaint about all of the interest charging events that took place within six years prior to this, had been raised in time. Which would be from 1 May 2014 onward. So, he was satisfied that he could consider whether the sums charged from 1 May 2014 onward were fair and reasonable.
- He noted that DISP 2.8.2(R) has two parts, the second providing for a scenario where the consumer seeks to bring a complaint more than six years after the event complained of. Specifying such a complaint must be brought within three years from the date the consumer became aware, or ought reasonably to have become aware, that they had cause for complaint. But he thought Mr and Mrs R ought reasonably to

have been aware they had cause for complaint from May 2009 at the latest (given their mortgage had reverted to the variable rate in February 2009 and had not tracked the well-publicised base rate falls). So, he didn't think this gave them any more time.

- The investigator set out that when considering the fairness of the interest rate charged from 1 May 2014 onward, he will need to take account of previous variations of the interest rate in order to determine whether the rate charged during the period he can look at is fair. He will also need to consider whether the variation clause is itself an unfair term as a matter of law. He concluded both of these things were part of 'all the circumstances of the case' that he is required to consider under the DISP rules and are relevant to whether the interest charged from 1 May 2014 onward is fair and reasonable.
- The investigator clarified that in the event he recommends any redress, he will only be able to award for the period that is in scope of this complaint – 1 May 2014 onward.

Mr and Mrs R accepted our investigator's findings on our jurisdiction.

NRAM responded to say it did not agree the complaint raised by Mr and Mrs R falls within the compulsory jurisdiction of the ombudsman service. But it also considers the merits of Mr and Mrs R's complaint to be without merit, so it was "content" with this service investigating and determining the substance of the complaint. However, it reserved its position on whether the complaint falls within our jurisdiction and may choose to submit further arguments on this point if it deems it necessary to do so.

The investigator went on to assess the merits of Mr and Mrs R's complaint, limited to the scope previously identified in his jurisdiction assessment. I've summarised his findings below:

- NRAM was not required to set out all the terms and conditions of the mortgage contract in a single document. There are good reasons why general terms and conditions would be in a separate document to an individual consumer's offer.
- The mortgage represented a substantial liability and a consumer ought reasonably to be treated as if they had read all the information provided with the mortgage offer, including the associated terms and conditions.
- Mr and Mrs R's mortgage contract did not commit to track the Bank of England Base Rate, they were made sufficiently aware of its terms and that NRAM has sought to charge interest in accordance with those terms.
- The SVR applied from May 2014 onwards was not set in a vacuum, but rather was the product of earlier decisions. So, it is necessary to consider how the SVR was varied to reach a decision about what is fair and reasonable in all the circumstances of the case.
- The variation clauses relate to the mechanism for amending the price of the services provided, rather the price itself. So, they are not a core term and their fairness can be assessed.
- The investigator was not persuaded at a general level that the relevant terms satisfy the wider transparency requirements. While he thought they were easy to follow grammatically, the terms are broad and the circumstances in which changes might be made give NRAM significant discretion about when it could make changes to the SVR and by how much. He found the reasons for variation to be wider than reasonably necessary to achieve a legitimate purpose and to be so subjective that

they do not explain to the consumer the method for determining the new price.

- He thought it would be difficult for a customer to understand the basis and mechanics for any decisions taken that relied on those terms, to be able to understand the economic consequences of entering into the agreement and, if necessary, to challenge a variation made in reliance on them.
- The investigator did not think national law would imply a term that gave a lender such wide discretion. So he was satisfied that they cause a significant imbalance between the parties and he didn't think a hypothetical consumer would have agreed to a term that enabled the lender to increase the SVR payable on their mortgage for such subjective and imprecise reasons.
- In determining whether, at the time the contract was taken out, there were likely to be significant barriers for Mr and Mrs R dissolving the contract, the investigator noted that NRAM were only able to rely on the variation terms when there was no ERC. So, Mr and Mrs R would have only had to pay the discharge fee (approx. £295) and other associated switching costs if they chose to move to another lender. The investigator didn't think these were a significant barrier to exit and instead were costs a borrower could incur if they ever sought to switch lender.
- However, there were special conditions attached to the unsecured loan linked to Mr and Mrs R's mortgage that may have made it more difficult for them to re-mortgage elsewhere. The unsecured loan had a 'de-linking premium' whereby they would have had to pay an additional rate of 5% on the unsecured loan if they moved the mortgage elsewhere but were not able to refinance the loan. The investigator thought it would've been reasonably foreseeable that it might have been difficult to refinance the unsecured personal loan as well as the mortgage. So, he was satisfied that this was a foreseeable and significant practical barrier to Mr and Mrs R dissolving the contract and had the potential to lead to unfairness.
- He thought a court may have a proper basis to conclude that, the combination of the breadth of the SVR variation terms and the potentially significant practical barriers to exit, meant that elements of the SVR variations terms were unfair. But set out this doesn't mean there has been an unfairness. He noted he was required to consider what is fair and reasonable in all the circumstances. That includes, but is not limited to, relevant law.
- He set out the need to consider what, if any, unfairness Mr and Mrs R experienced because of mortgage payments based on changes to the interest rate. And the need to consider whether NRAM had exercised the terms fairly.
- He found SVRs to serve a legitimate purpose in permitting lenders to provide for future changes and allow borrowers flexibility.
- The investigator was not persuaded NRAM varied the rate unfairly.
- Between August 2007 and April 2009, the SVR only reduced – but the difference between the SVR and the base rate increased. The Investigator doesn't think a term that reduces the rate, and therefore the amount of interest Mr and Mrs R would pay each month, is likely to be unfair as a matter of law.
- Significant change occurred during this period because of the global financial crisis (GFC). This impacted the funding costs of businesses and was reflected in changes to several lenders' interest rates charged across the market at the time. In addition, NRAM required government assistance in the form of a loan during this time which it had to repay as quickly as possible.
- NRAM reduced its SVR in light of the base rate reductions – but not to the same proportion, leading to the difference between the two increasing. However, it has

evidenced that this was not an arbitrary decision or purely to increase its own profits as alleged by the representative. And instead, was NRAM balancing its financial position and obligations at the time with the impact any changes would have on its customers. Given these factors, and that the terms did not obligate NRAM to track base rate, the investigator did not think that the changes to the interest rate in this period resulted in unfair treatment of Mr and Mrs R.

- After 2010, the only changes made to the SVR were in line with changes made to the base rate, and so the margin between the SVR and the base rate during that period has remained the same. NRAM has shown the SVR was continually reviewed during this time and it had regard to the changes being made by other lenders and its continuing obligations under the Government loan. During that period, the interest on the Government loan was directly set by reference to base rate, and that resulted in NRAM's costs becoming more in line with those movements, hence it made the changes to the SVR in line with changes to base rate.
- So, while the terms do provide NRAM with a significant amount of discretion in regard to when or whether to vary the SVR on Mr and Mrs R's mortgage - the investigator didn't think this had resulted in Mr and Mrs R being treated unfairly.

NRAM responded to say it agreed with the investigator's assessment but reserved its right to make further submissions on the complaint should it proceed to an ombudsman.

Mr and Mrs R responded via their representative to say they were very disappointed in the outcome reached and would like their case to be reviewed by an ombudsman. Their representative asked a series of questions, which our investigator went on to address, and made several comments which I have summarised as:

- The assessment did not address the fairness of the unsecured loan, the interest rate of the loan or the implications of the mortgage redeeming prior to that loan being redeemed.
- In relation to the fairness of the SVR, and whether NRAM treated Mr and Mrs R fairly, it provided independent, expert evidence which confirms that the cost of funds dropped following the financial crisis. This contradicts NRAM's evidence. The investigator has not confirmed if he relied on this report and if so, what weight he put on it. Similarly, the representative has not had sight of the evidence provided to the ombudsman service by NRAM, so neither it nor the expert are able to comment on or disprove it.
- The investigator has confirmed that NRAM's commercial strategy during the financial crisis was impacted by the Government loan and the need to repay the loan as quickly as possible. It appears inconceivable that NRAM were not driven by a desire to repay that loan as quickly as possible, which required increasing their profits, and the means to do so was by maintaining an SVR rate above the industry norm and the base rate. This amounts to pure profiteering.
- It strongly challenges the investigator's conclusion that NRAM had regard to the impact any changes would have on its customers, and balanced that reasonably with its financial position and obligations at the time.

Our investigator sent a letter to both parties, endorsing his previous assessment letter and responding to the queries raised by Mr and Mrs R's representative. I've summarised his key points below:

- Each time NRAM varied the interest rate, it was prompted by a change in the Bank of England Base Rate. But the amount by which NRAM varied the SVR was linked to its cost of funds and obligations under the Government loan it had received.

- He did consider the expert report which it believes shows cost of funding dropped following the financial crisis. But other independent sources, such as the Bank of England and the FCA have explained historically the impact the crisis had on mortgage lenders' costs of funds. And from weighing up all the evidence, he was persuaded that, generally, the difference between base rate and lenders' costs of funding increased during the 2008-2009 period.
- Our service is free to receive evidence in confidence from the parties when appropriate. And it would not be appropriate to share some of the information NRAM has sent us about the decision process behind the rate changes throughout the relevant period.
- The Government loan came with conditions and NRAM had to ensure it was not distorting competition in the market by, for example, charging rates that were overly competitive compared to other lenders. This was a legitimate factor to take into account.
- He was not persuaded NRAM's intention was to make significant profits, but rather to reduce its balance sheet (by encouraging as many customers as possible to redeem their mortgages) so that the Government loan could be repaid.
- As more customers redeemed their mortgage, the level of risk associated with NRAM's mortgage book was greater, and that further played a part in its overall pricing strategy to ensure it remained solvent and able to meet its obligations.
- Overall, having seen the considerations NRAM had regard to when making decisions to vary the SVR, the investigator was satisfied it took legitimate and justifiable business decisions, balancing its prudential requirements, obligations as a result of the Government loan and the need to treat its customers fairly.
- Looking at the rates charged across the whole market at the time, the investigator did not consider the rate to be unfairly high.
- The existence of Mr and Mrs R's unsecured loan was considered by the investigator to the extent that it impacted his analysis of whether the interest rate variation terms could be considered unfair as a matter of law. But any concerns about the fairness of the loan would be a separate matter that would need to be dealt with as a freestanding complaint.

The investigator confirmed that he would pass the case to an ombudsman for a final decision – inviting both parties to provide any further comments or information they would like the ombudsman to consider by 9 December 2022.

Quanta Law did not make any further representations.

NRAM responded to say that it agreed with the overall outcome reached by the investigator. However, it disagreed with the conclusion that the relevant terms could be subject to an assessment of fairness as per UTCCR.

It considers the investigator to have misapplied case law, introduced irrelevant considerations when determining whether the relevant terms meet the requirement for transparency and to have failed to provide factual evidence to support his conclusion Mr and Mrs R faced a significant barrier to exit the contract.

NRAM also provided a report assessing the fairness of its SVR by Grant Thornton.

As the complaint could not be resolved informally and as the deadline for the parties to respond has now passed, it is now appropriate for me to issue my decision.

**What I've decided – and why**

NRAM disputed our jurisdiction on two key grounds:

1. The activity complained of is not one that falls within the compulsory jurisdiction of this service.
2. Mr and Mrs R's complaint is out of time pursuant to DISP 2.8.2R.

Setting and changing interest rates is part and parcel of the activity of 'lending money secured by a charge on land' and if I'm wrong about that, it is at least, ancillary to that activity. So, I am satisfied our service has the power to consider the activity Mr and Mrs R have complained about (DISP 2.3).

In respect of whether the complaint was brought in time, I'm satisfied I have the jurisdiction to consider the complaint from 1 May 2014. Complaints about charges before this date are out of time as per DISP 2.8.2R.

In considering the fairness of interest charged from 1 May 2014 onwards, I need to consider the whole history of the interest rate, including before 1 May 2014. That is because each time NRAM made a decision to change the SVR, the SVR remained at that revised level until it made a further decision to change it – from the starting point of the level resulting from the previous variation. Therefore, the SVR charged from May 2014 is the "sum of the parts" of the history that went before. And if any of those parts were themselves potentially unfair, that *might* mean that the SVR charged from May 2014 is itself unfair.

I will also need to consider whether the variation clause is itself an 'unfair term' as a matter of law. Both of those things are part of 'all the circumstances of the case' that I'm required to consider under the DISP rules and are potentially relevant to whether interest charged from 1 May 2014 onwards is fair and reasonable.

The courts have confirmed (since NRAM's objection) the correctness of this approach to our jurisdiction in cases like this. And, given my conclusions on the merits, it doesn't ultimately affect the outcome of the complaint, so I don't propose to comment on jurisdiction further.

In deciding the merits of this case, I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

When considering what is fair and reasonable in all the circumstances, I am required by DISP 3.6.4R of the Financial Conduct Authority's ("FCA") Handbook to take into account:

> '(1) relevant:
>
> > (a) law and regulations;
> >
> > (b) regulators' rules, guidance and standards;
> >
> > (c) codes of practice; and
>
> (2) (where appropriate) what [I consider] to have been good industry practice at the relevant time.'

I also focus on what I think is material and relevant to reach a fair and reasonable outcome. So, although I have read everything that has been supplied to me, I may not address every point that has been raised.

Having done all that, I don't think this complaint should be upheld. I realise this will be disappointing for Mr and Mrs R. But I hope the reasons I have set out below will help them to understand why I have come to this conclusion.

Mr and Mrs R's representative has raised many individual complaint points both to NRAM directly and to this service. However, like the investigator, I consider their overall complaint to break down into two key points:

1. Mr and Mrs R had an expectation that their mortgage would track the Bank of England Base Rate once it reverted to the variable rate. As it did not do so, NRAM has treated them unfairly.

2. NRAM has not varied its SVR fairly or in line with the mortgage terms and conditions. And the terms that set out how the SVR may be varied are unfair. This has resulted in Mr and Mrs R paying a higher rate of interest on their mortgage balance than they should have.

I will deal with each point in turn.

*Was NRAM under a contractual obligation to charge Mr and Mrs R an interest rate that tracked the Bank of England Rate?*

As I set out above, any complaint points relating to what Mr and Mrs R were told or led to believe at the point of sale in August 2007 are out of time. But I can consider whether NRAM was under a contractual obligation to charge an interest rate that tracked the Bank of England Base Rate.

Having reviewed the mortgage documentation that makes up Mr and Mrs R's mortgage contract, I am satisfied the mortgage is not a tracker mortgage and NRAM was not under a contractual obligation to ensure its SVR tracked the Bank of England Base Rate.

I am aware Mr and Mrs R's representative argues that, as the mortgage general terms and conditions were not included in the mortgage offer letter, they should not form part of the mortgage contract. I disagree with this conclusion.

NRAM was not obligated to set out all the terms and conditions governing its mortgages in one document. And while I appreciate this means Mr and Mrs R would need to read more than one document to understand and appreciate the terms that governed their mortgage, given this was a substantial liability, secured on their principle asset, I think Mr and Mrs R ought reasonably to be treated as if they had read all of the information provided.

So, it follows that I do not uphold this part of Mr and Mrs R's complaint.

*The fairness of the interest rate terms*

To assess the fairness of the interest rate terms, it is helpful to first set out the relevant terms themselves:

Section 4 of the mortgage offer states:

> *"This secured mortgage is based on the following interest rate periods:*
>
> - *A fixed rate of 6.55% until 1 February 2009 followed by*

- *A variable rate which is guaranteed to be below Northern Rock Standard Variable Rate, which is currently 7.84% for the remainder of the term of the mortgage.*

*Please note that the payments illustrated for this period of the mortgage in Section 6 of this document are based on Northern Rock's current Standard Variable Rate….It is important that you read Section 12 which details additional features relating to this product,"*

Section 12a of the mortgage offer sets out:

*"On expiry of the Special Rate Period the rate will be set at a rate guaranteed to be below our prevailing Standard Variable Rate set by us from time to time for existing Northern Rock borrowers (the Guaranteed Rate). We will review the Guaranteed Rate on the 1st of each month following any change in the Standard Variable Rate. Should the Standard Variable Rate change and we are required to change the rate as a result of the guarantee, we will amend the rate of interest payable by you on the 1st day of the following month or such other day as we may reasonably determine.*

*At any time during the Rate Periods our prevailing Standard Variable Rate may be lower than the product you have chosen. In such circumstances we are under no obligation to reduce the Interest Rate you pay."*

The Mortgage Offer General Conditions (2005) set out:

*"**Standard Variable Rate** means such rate as we from time to time decide to set as the base from which to calculate Interest on our variable rate mortgage loans (disregarding the restrictions on what we can charge under condition 7 or the Offer). The current Standard Variable Rate which applies to your Loan is set out in the Offer. We may change this rate from time to time under Condition 7 of the Offer. If we transfer or dispose of the Offer, the person to whom we make the transfer may change the rate to its own base rate which applies to its variable rate mortgage loans. That rate will then be the Standard Variable Rate under the Offer and the person to whom we make the transfer may make further changes to that rate under condition 7 or the Offer."*

*"**7. Changing the Interest Rate***

*7.1 We may reduce the Standard Variable Rate at any time.*

*7.2 We may increase the Standard Variable Rate at any time if one or more of the following reasons applies:*

*(a) there has been, or we reasonably expect there to be in the near future, a general trend to increase interest rates on mortgages generally or mortgages similar to yours;*

*(b) for good commercial reasons, we need to fund an increase in the interest rates we pay to our own funders;*

*(c) we wish to adjust our interest rate structure to maintain a prudent level of profitability;*

*(d) there has been, or we reasonably expect there to be in the near future, a general increase in the risk of shortfalls on the accounts of mortgage borrowers (whether generally or our mortgage borrowers only), or mortgage borrowers (whether generally or our mortgage borrowers only), whose accounts are similar to yours;*

*(e) our administrative costs have increased or are likely to do so in the near future."*

*7.3 We will tell you of any change in the Standard Variable Rate and the Interest Rate in one of the following ways:*

*(a) by posting or delivering the notice to you in accordance with condition 24; or*

*(b) by publicising the change as follows:*

*(i) by displaying a notice of the change at our registered office and all our branch offices (if any); and or*

*(ii) by advertising the notice in two or more national daily newspapers chosen by our board of directors (which will keep a list of the newspapers currently chosen by it for this purpose).*

*If a Loan is a capped rate loan or a fixed rate loan (the Conditions will indicate if a Loan is a capped rate loan or a fixed rate loan, and if so what any capped rate period and fixed rate period is) we are not obligated to give you notice of any changes that occur in the Standard Variable Rate during any period when such changes do not affect the rate you are charged during that period, for example when the Standard Variable Rate is higher than the capped rate or during any fixed rate period.*

*7.4 Any notice we give under condition 7.3 will state the date on which the new rate is to come into effect, which we call the "Interest Change Date." The Interest Change Date must not be earlier than the date when the notice under condition 7.3 is given. For this purpose:*

*(a) a notice displayed under condition 7.3(b)(i) is to be treated as given on the date on which we display it at our registered branch offices (if any) (ignoring any accidental failure to display it at a branch office); and*

*(b) a notice advertised under 7.3(b)(ii) is to be treated as given on the first date by which the notice has appeared in each of the newspapers chosen by our board of directors."*

NRAM has told us it relied on Condition 7.1 for all reductions to the base rate. In 2018, the SVR did increase following increases to base rate. NRAM has said it relied on Conditions 7.2 (a) & (b) to make these changes. It has also said it wrote to Mr and Mrs R each time it varied their interest rate as per Condition 7.3.

One of the considerations that I am required to take into account is relevant law. I consider that the application of the UTCCRs to the relevant terms in this case falls into that category of relevant law. The way the UTCCRs apply to the relevant terms of Mr and Mrs R's mortgage contract is ultimately a matter for the courts. But they are a relevant consideration I must take into account when determining what is fair and reasonable in all of the circumstances of this case.

The relevant test as to whether a term is unfair is set out at Regulation 5(1), as follows:

*'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 the contractual term shall be assessed, taking into account the nature of the goods and 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 on which it is dependent*
>
> *(2) In so far as it is in plain and 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."*

So, it is important to note, that I must consider whether the variation terms were unfair based on the situation when Mr and Mrs R took the mortgage out. And whether the terms in question go to the main subject matter of the contract or the adequacy of the price/remuneration.

Schedule 2 to the UTCCRs sets out a grey list of indicatively unfair terms and various factors relevant to assessing the fairness of a term. The grey list includes:

*"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…"*

The grey list of indicatively unfair terms is subject to the qualifications to be found in in paragraph 2 of Schedule 2 of the UTCCRs. For example, paragraph 2(b) of Schedule 2 of the UTCCRs identifies that the indication of unfairness under paragraph 1(j) is *'without hindrance'* to terms under which a supplier of financial services reserves the right to:

- change a rate of interest payable without notice where there is a valid reason (provided the supplier informs the consumer *'at the earliest opportunity'* and the consumer is *'free to dissolve the contract immediately'*);
- alter unilaterally the conditions of a contract of indeterminate duration (provided that he is required to inform the consumer with reasonable notice and that the consumer is free to dissolve the contract).

As a matter of law, if the relevant clauses in this case are unfair under the UTCCRs, they would not be binding on Mr and Mrs R (Regulation 8 UTCCR). And NRAM would not have been permitted under the terms and conditions to vary the SVR in the way that it did.

In considering these matters, it is relevant to note that the Court of Justice of the European Union ("CJEU"), having identified that ultimately the fairness of a term was a matter for the national court to decide, has indicated what national courts should take into account when making that decision:

- in *Invitel*, (C-472/10), the court concluded that a price variation clause in a contract is not a 'core term'. Identifying that a price variation clause was instead a *"term relating to a mechanism for amending the prices of the services provided to the consumer"*.

- in *RWE*, (C/92/11), the court emphasised that, for unilateral price variation clauses (falling within paragraphs 1(j) or 1(l)) to be fair, they must specify the reasons and methodology for the price variation 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. The CJEU also placed importance on whether the right to exit a contract in the event of a unilateral price variation can practically be exercised by the consumer at the time, having regard to the circumstances of the market as it exists at the time.

- in *Kasler*, (C-26/13), the CJEU identified that, when assessing the fairness of a unilateral variation clause – and the meaning of *'plain intelligible language'*, national courts ought to consider whether: a) the mechanism expressed in the reasons for the variation is transparent; such that b) it would enable a consumer to foresee and predict the economic consequences for him or her.

- 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 renumeration, so that the consumer can foresee, on the basis of clear, intelligible criteria, the economic consequences for him which derive from it.

The leading UK judgement on the UTCCR is the 2015 Supreme Court case ParkingEye v Beavis. In this case the Court said that:

- The test for establishing a significant imbalance (Regulation 5(1)) includes, but is not limited to, asking whether the terms of 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 is also of relevance. This paper sets out 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".* The guidance also provides an overview of factors relevant to determining whether a variation term is fair. At paragraphs 66 and 67 the guidance states 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.

*Application to Mr and Mrs R's complaint*

Having considered the above, I am satisfied I need to address the following in deciding whether the 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.

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 standing back to consider the term in its full context, both within the contract and in all the surrounding circumstances.

- Is the relevant term a core term?

The terms in question relate to the mechanism for amending the price of the services provided, not the price itself. So, I am satisfied they are ancillary terms whose fairness can be assessed under the applicable fair terms legislation.

I'm aware from its submissions that NRAM considers the case law to instead support its position that Condition 7 *is* a core term and therefore cannot be subject to an assessment of fairness. But I disagree for the reasons I've already set out.

- Do the terms create a significant imbalance contrary to the requirements of good faith?

As set out above, one of the considerations when determining if the terms create a significant imbalance is 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 am not persuaded that the interest rate variation clause applicable to Mr and Mrs R's mortgage contract does this. At a general level, such clauses have a legitimate purpose and are common in financial services consumer contracts. Particularly those of long or indeterminate duration, such as mortgage agreements. A fair variation term can benefit both consumers and lenders. Providing flexibility and a wider choice to consumers and enabling firms to provide competitively priced products, knowing they can vary the interest rates they charge to reflect changes in circumstances, particularly in their own costs of funding...[1]"

A reversion rate also permits 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 a mechanism for allowing a lender to vary the rate for legitimate reasons. And I think the average consumer could reasonably be assumed to accept this and agree to it in hypothetical negotiations.

The key issue is whether the terms in Mr and Mrs R's agreement go further than reasonably necessary to protect NRAM's legitimate interests, whether the variation clauses are sufficiently transparent and whether there were significant barriers to Mr and Mrs R dissolving the contract.

Taking everything into account, including the case law set out above, I am not satisfied that the terms necessarily meet the wider transparency requirements. While grammatically they are easy to follow, the relevant terms allowing for the SVR to be varied are broad, and the

[1] FCA Guidance (FG18/07 Paragraph 34)

circumstances in which changes might be made give NRAM significant discretion about when it can make changes to the SVR and by how much.

The broadest part of the term relates to reductions in the rate, as this doesn't require NRAM to rely on any particular circumstances to make the change – Condition 7.1. But I can't see that a term which gives a lender the unfettered ability to reduce the rate payable, could be considered to create a significant imbalance between the lender and consumer to the detriment of the consumer, contrary to the requirement of good faith. The lack of restrictions on reducing the interest rate increases the situations in which the interest rate might fall, and so is in the consumer's favour

In considering Condition 7.2, I think it's possible a court may find that the following clauses are not sufficiently transparent such that an informed consumer would have agreed to them in individual negotiations:

*"B. for good commercial reasons, we need to fund an increase in the interest rates we pay to our own funders"*

*"C. we wish to adjust our interest rate structure to maintain a prudent level of profitability…"*

I am not persuaded a consumer would necessarily be able to understand the basis and the mechanics for any decisions taken that relied on these terms or to be able to understand the economic consequences of entering into the agreement and, if necessary, to challenge a variation made in reliance on them. I consider these terms potentially to be wider than are reasonably necessary to achieve a legitimate purpose and they do not explain to the consumer the method for determining the new price – 'good commercial reasons' and 'a prudent level of profitability' are very vague terms.

While I do think that a term enabling NRAM to increase the SVR proportionately to reflect increases in its cost of funds in specific circumstances would be fair, I think Condition 7.2 (b) and (c) go beyond what national law would likely imply. I think it's possible a court could find that they cause a significant imbalance between the parties and I think it's unlikely a hypothetical consumer would have agreed to a term that enabled the lender to increase the SVR payable on their mortgage for such vague reasons.

Having reached this conclusion, I also need to consider whether – at the time the contract was taken out – there were likely to be such significant barriers to Mr and Mrs R dissolving the contract that they could not effectively make use of the right to do so. If there were such barriers, that may mean that the variation terms are unfair.

In assessing whether the term itself is unfair – the test is not whether there were significant practical barriers for Mr and Mrs R at the point at which their interest rate 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 ERC applicable to Mr and Mrs R's mortgage at the point they reverted to the Guaranteed Rate on 1 February 2009. So if NRAM had exercised its rights as set by the variation term, and Mr and Mrs R were unhappy with that decision, they were free under the contract to transfer their mortgage to another lender should they have wished without having to pay this charge.

Mr and Mrs R's representative has said that other costs impacted on Mr and Mrs R's ability to redeem their mortgage and transfer to another lender such as the discharge fee and other associated switching costs. I have considered this carefully, but I'm not satisfied that this fee was a 'significant barrier' to their ability to redeem the loan in the way that an ERC would be.

The discharge 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 mortgage offer. And with regards to switching costs, I am 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. Mr and Mrs R would incur these costs if ever they sought to switch lender.

However, while I do not think the mortgage discharge fee or other associated switching costs presented a practical and significant barrier to Mr and Mrs R dissolving the contract should they have wanted to, I do think it was reasonably foreseeable that Mr and Mrs R may struggle to refinance both their mortgage and unsecured loan. Given the special conditions attached to the unsecured loan, I think this was a real and practical barrier to Mr and Mrs R dissolving their mortgage contract with NRAM.

With this in mind, alongside my finding that the terms do not necessarily satisfy the requirement for transparency, I think these terms had the potential to lead to unfairness, because if NRAM increased the SVR for an unclear reason, Mr and Mrs R may not realistically be able to dissolve the contract and move elsewhere. So, I think a court may have a proper basis to conclude that elements of the variation terms were unfair.

I’m aware from its submissions that NRAM disagrees with much of what I have set out here. However, while I have read and considered its comments and analysis as to why it disagrees, I don’t think its submissions change my overall outcome as to what is a fair and reasonable outcome to Mr and Mrs R’s complaint. I have set out why below.

Legally, the effect of a term being unfair as a matter of law, is that it won’t apply. And Mr and Mrs R’s representative says it should be replaced using a ‘reasonable rate’ pursuant to s.15 of the Supply of Goods and Services Act. But the presence of an unfair term doesn’t necessarily mean there has been an unfairness such that I automatically uphold the complaint. Under our rules I am 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 the *way* the terms have been used has resulted in Mr and Mrs R being treated unfairly.

**Has NRAM exercised the terms fairly?**

In answering this question, I am doing so in the context that this complaint only concerns the fairness of interest charged to Mr and Mrs R’s mortgage since May 2014. All interest charging events before that point are out of time because Mr and Mrs R did not refer their complaint to the Financial Ombudsman Service in time.

However, in order to consider the fairness of the interest Mr and Mrs R were charged during the period that is in time, it’s necessary for me to consider historic changes to NRAM’s SVR, since the SVR charged during the period of time that is in time is the result not only of decisions NRAM made during that period, but also the result of decisions it made prior to it.

I’m satisfied that each time NRAM made a decision to change the SVR, the SVR remained at that revised level until it made a further decision to change it – from the starting point of the level resulting from the previous variation. Therefore, the SVR charged from May 2014 is the “sum of the parts” of the history that went before. And if any of those parts were themselves potentially unfair, that *might* mean that the SVR charged from May 2014 is itself unfair.

Having established that I need to look at the SVR both before and after May 2014, and having considered all the available evidence, I am not persuaded NRAM has varied the rate unfairly. I have set out why below.

Between August 2007 (when Mr and Mrs R took out their mortgage) and April 2009, the SVR only reduced. But the difference between the SVR and the base rate increased from 2.09% to 4.29%.

I've already set out that this was not a tracker mortgage so NRAM was not contractually obligated to track the base rate. Nor is it the case that Mr and Mrs R's mortgage had a 'cap' preventing NRAM's SVR from increasing beyond a certain 'margin' above base rate. In addition, I've already explained that I don't think a term allowing NRAM to reduce the SVR, and with it, the amount Mr and Mrs R had to pay, is likely to be unfair in principle as a matter of law. So, these changes are not impacted by the question of whether on a strict legal analysis the term would apply.

But it is necessary to determine whether the way in which NRAM exercised this term was fair.

NRAM has provided us with evidence to show how it reviewed the SVR over the relevant period, the decisions it took when it came to varying the rate and by how much as well as its general commercial strategy at the time. For reasons of commercial confidentiality, I haven't set out the evidence provided by NRAM in full or provided copies of it to Mr and Mrs R. Our rules allow me to accept information in confidence, so that only a description of it is disclosed, where I consider it appropriate to do so. In this case, I do consider it appropriate to accept the information and evidence NRAM has provided in confidence, subject to the summary of it I have set out in this decision.

During this time, the mortgage market was going through a period of significant change as a result of the global financial crisis. This impacted the funding costs of businesses and was reflected in changes to a number of lenders' interest rates charged across the market at the time. This was clear at the time and has been the subject of analysis by both the Bank of England[2] and the FCA[3] since. Whilst the base rate did reduce significantly during this period, the cost to lenders of funding their businesses changed, as did their prudential requirements. These were made up of several factors and that are not directly linked to base rate. There was a substantial risk to all lenders during this period and they all had to find ways to mitigate that risk while balancing the need to treat customers fairly.

NRAM has told us that, like many lenders at the time, it was predominantly funded by wholesale funding. The cost of which was in the most part, contractually defined by reference to LIBOR and LIBOR generally followed base rate prior to the financial crisis. As a result, changes in base rate tended to result in changes to cost of funding. Before the financial crisis, changes in costs of its retail funding also tended to correspond to changes in base rate.

However, during the financial crisis, there was a significant dislocation between LIBOR and base rate, such that reductions in base rate were not matched by commensurate reductions to LIBOR or to NRAM's cost of wholesale funding. In addition, access to wholesale funding became harder to come by as lenders became more concerned at the risk of default - NRAM in particular has shown how its credit rating was impacted and the implications this had on

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[2] Quarterly Bulletin, Q4 2014, Bank of England – Bank funding costs: what are they, what determines them and why do they matter?

[3] May 2018 Guidance Consultation GC18/2 Fairness of Variation terms in financial services consumer contracts under the Consumer Rights Act paragraphs 2.8 to 2.10

its ability to raise and the cost of its funding. It also experienced an outflow of its retail savings deposits following negative press in late 2007.

To avoid collapse, NRAM received State Aid in the form of a Government loan in September 2007. With the aid, came several conditions on how NRAM could operate and obligations on how and when it should look to repay the loan. Understandably, this significantly impacted its commercial strategy and with it, the cost of funding mortgages like Mr and Mrs R's. To add to this, NRAM was nationalised in February 2008 with its entire share capital being transferred to HM Treasury. One of the conditions of the restructure was that NRAM would be limited to a maximum 1.5% share of all retail funding in the UK and 0.8% in Ireland.

In addition, as part of its restructure, it was agreed NRAM would transfer all its higher quality assets to a third party, whilst the lower quality assets would remain with NRAM and be wound down. Given the perceived 'quality' of its remaining assets, this had a further impact on the cost of NRAM's funding.

While Mr and Mrs R's representative considers the obligations to repay the Government loan as quickly as possible could only have led to pure profiteering on the part of NRAM, I am not persuaded this was the case. NRAM reduced its SVR on several occasions during this period, just not by the same proportion as the base rate. Given the documented increase in cost of funding across the industry, including for NRAM specifically, and the obligations surrounding the Government loan, I am satisfied NRAM balanced its own financial position and obligations at the time with the impact such changes would have on customers like Mr and Mrs R.

And while NRAM's SVR was at the higher end of what was being charged across the industry at the time, it was not an outlier, with several lenders charging a higher SVR. While the SVR charged by other lenders is not directly relevant to NRAM's cost of funds, these factors reassure me in my conclusion that NRAM's decisions on how much to reduce its SVR by were proportionate to the costs it – along with the rest of the industry – faced at this time and not unfair.

I have not seen any evidence to suggest the changes it made were arbitrary, excessive, or unfair. Rather, the evidence I've seen satisfies me that NRAM acted to protect its legitimate interests while balancing its obligation to treat Mr and Mrs R fairly. And I'm further satisfied that the evidence NRAM has provided is corroborated by evidence of wider market conditions at the time.

While I note and have considered in full the expert report provided by Mr and Mrs R's representative, I am not persuaded it outweighs the business specific evidence provided by NRAM on the impact of the financial crisis on its own cost of funding, and as I have said above, I have considered other sources such as the Bank of England that lead me to a different conclusion.

After 2010 the only changes made to the SVR were in line with changes made to the base rate. And NRAM has shown that the SVR was continually reviewed, with it having regard to the changes made by other lenders and its continuing obligations under the Government loan.

So, while I accept that a court may potentially find the relevant terms to be unfair pursuant to UTCCR, I am not persuaded that NRAM operated them in an unfair manner when setting and varying the interest rate that applied to Mr and Mrs R's mortgage or that they have led to Mr and Mrs R being charged an unfairly high rate of interest on their mortgage.

I have also considered the representative’s suggestion that NRAM has breached Principle 6 of the FCA Handbook and MCOB 11.5(1)(b). Having done so, and for much the same reasons set out above, I’m not persuaded it has.

Finally, I note that at an earlier stage in the Ombudsman Service’s consideration of this complaint, the representative argued that NRAM had breached it’s ‘Braganza’ duty not to exercise its discretion to vary the SVR arbitrarily, capriciously, perversely or irrationally. For the reasons set out above, if there was such a duty in the present case, I’m satisfied that NRAM did not breach it since it approached the question of varying the SVR fairly and rationally.

**My final decision**

Considering everything, and 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 R and Mrs R to accept or reject my decision before 25 February 2023.

Lucy Wilson
**Ombudsman**