DRN-3940048

The complaint

Miss C, represented by her solicitors, complains that Landmark Mortgages Limited ("LML") treated her unfairly by overcharging her on her mortgage.

What happened

Miss C took out a mortgage with Northern Rock in June 2005. It was initially taken out on a fixed interest rate of 5.99% until 1 August 2010. The mortgage also had a secured loan attached to it. The terms governing the unsecured loan provided that the rate payable on that loan would increase by an additional 5% if it was 'delinked' from the main mortgage.

The mortgage was initially taken out in joint names. In 2007, one of the borrowers was removed and a new party added. That party was subsequently removed in 2012. In total therefore, three mortgage offers have been issued. One in 2005, one in 2007 and one in 2012. The mortgage was redeemed in 2019.

The name of the company which held Miss C's mortgage changed during the term from Northern Rock plc, to Northern Rock (Asset Management) plc (NRAM) and finally to LML. For the most part I will refer to LML throughout this decision, but there will be occasions when it is appropriate to refer to the other company names.

Since Miss C's mortgage was taken out, the Bank of England base rate and the SVR have operated as follows:

Effective Date	Base rate	SVR	Difference
08/06/2005	4.75%	6.84%*	2.09%
05/07/2007	5.75%		
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%
01/08/2010		Fixed rate ends**	
04/08/2016	0.25%		
01/09/2016		4.64%	4.39%
02/11/2017	0.50%		
01/01/2018		4.79%	4.29%
02/08/2018	0.75%		
01/10/2018		5.04%	4.29%

* The date of Miss C's first mortgage offer with Northern Rock
** The date Miss C's fixed rate ends

On 12 March 2020, Miss C's representative sent a letter of complaint to LML on Miss C's behalf. The letter set out that Miss C sought to claim damages in relation to being overcharged interest on her outstanding mortgage balance due to the "unlawful interest rates" and any variations in the interest rates charged by LML, formerly Northern Rock plc.

The letter set out that Miss C considers that the mortgage offers issued on 8 June 2005, 28 November 2007 and 7 December 2012 contained unfair terms pursuant to the Unfair Terms in Consumer Contracts Regulations 1999 ("UTCCR"). Elaborating on this point, Miss C's representative 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 Miss C was misled into believing that this rate would vary in accordance with the Bank of England Base Rate, rather than at the lender's discretion.
- Miss C does 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 Miss C, 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 the lender 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 LML 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 Miss C 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 her 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 Miss C's mortgage balance rather than LML's Guaranteed Rate.
- LML'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.

- Miss C seeks to claim the difference between the amount of interest she paid on her mortgage and the amount she would have paid had it been subject to what she deems to be a reasonable rate.

LML responded to the initial letter of complaint on 8 July 2020, disagreeing with Miss C's allegations. In summary, LML argued:

- There is no evidence to support the assertion that Miss C was 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 does not accept that it is unfair to expect Miss C to have read the mortgage documentation.
- It doesn't agree that the variation terms are in line with the examples set out in Schedule 2 of UTCCR.
- It notes that notice was given to Miss C ahead of decisions to vary her SVR and that she was free to dissolve the contract from 1 August 2010 without charge as the ECR ceased to apply on this date. It doesn't accept that the mortgage discharge fee or switching costs present significant barriers to exit the contract.
- It disagrees that s.15 of the Supply of Goods and Services Act 1982 applies to Miss C's case.
- It does not accept it breached its statutory duty or that Miss C has articulated why she thinks this is the case.
- It considers the claim and complaint to be time-barred.

Miss C, via her representative, referred her complaint to this service on 21 October 2010.

In response to our request for its file on the complaint, LML raised an objection to our service considering the case. In summary, it said:

- It does not consent to the Financial Ombudsman Service investigating any variations to Miss C's rate and the margin between it and the Bank of England Base Rate, prior to 12 March 2014. It considers any complaint relating to interest charged before that date to have been brought too late under our rules.

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

- The complaint point that, at the point of sale, Miss C was misled into believing the SVR would track base rate had not been brought in time, under DISP 2.8.2(R).
- The complaint was raised on 12 March 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 12 March 2014 onward. So, he was satisfied that he could consider whether the suMiss Charged from 12 March 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, given what her representative has

said she knew at the time, Miss C ought reasonably to have been aware she had cause for complaint from July 2009 at the latest (when she received a letter letting her know that the interest on her mortgage would be changing). So, he didn't think this gave her any more time.

- The investigator set out that when considering the fairness of the interest rate charged from 12 March 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 12 March 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 – 12 March 2014 onward.

Miss C accepted our investigator's findings on our jurisdiction.

LML responded to say it had "no further submissions to make on the question of jurisdiction at this stage, and is content for the FOS to consider the complaint…"

At a similar time, Miss C's representative sent in a summary of its legal analysis that it considers applies to cases like Miss C's and two reports:

- Retail Mortgages Expert Report
- UK Mortgage Prisoner Action Group Report

It considers the first report to show how cost of funding mortgages is directly linked to the Bank of England Base Rate and that where the margin differential has increased, this can only be explained as pure profiteering by the lender. And the second report to show how this is exacerbated for 'mortgage prisoner' borrowers, who have mortgages with inactive lenders.

The additional submissions were provided to LML for its own consideration and it chose to make further submissions of its own. In summary it said:

- Miss C's mortgage contract specified that the rate to apply after her fixed-interest period expired was a variable rate. The contract identified the SVR as it was at the time and the circumstances in which it could be varied by the lender.
- There is no basis in law to challenge the variation terms under the UTCCRs. The form and content of the mortgage offer were prescribed by mandatory provisions of MCOB. The UTCCRs are not applicable to terms that are mandated by regulatory provisions: Regulation 4(2)(a) UTCCRs. In addition, Section 4 of the mortgage offer is not subject to an assessment of fairness under UTCCRs because it related to the main subject matter of the contract and/or to the adequacy of the price or renumeration; and (b) is in "plain, intelligible language": Regulation 6(2) UTCCRs.
- In any event, the relevant term is not unfair. The terms and conditions of Miss C's mortgage were clearly documented and were agreed to by her. The terms were transparent, unambiguous, and easily understood. Read as a whole, the mortgage offer clearly explained the economic implication for Miss C of entering into the mortgage.
- Each variation in the interest rate applicable to her loan was notified to Miss C in

advance. Contrary to the arguments advanced, the mortgage contract provided Miss C with an effective right of termination following the exercise of any change in the SVR which applied to her account. Miss C was free to redeem her mortgage, with no applicable ERC, at any time after 1 August 2010.

- The essence of Miss C's complaint is that her mortgage should be converted retrospectively to a lifetime tracker mortgage. This is contrary to the express terms of the mortgage contract to which she agreed.

- There was no contractual requirement on LML for its SVR to track Base Rate, or any other benchmark.

- Miss C alleges that an implied term should be incorporated into her contract to impose additional duties and restrictions on LML to take account of certain considerations or disregard others when deciding the level of the SVR. However, she has not demonstrated that such a term is "necessary" because without it the contract lacked commercial or practical coherence (which is the legal threshold for the implication of such a term).

- It is settled law that a term may only be implied into a contract if it is not inconsistent with its express terms. Miss C's mortgage contract contains express terms which are contrary to, and inconsistent with, the content of the term she suggests should be implied.

- The consequence of upholding Miss C's complaint would be to prevent a lender from taking into account its own commercial considerations. The law recognises that there is nothing untoward or irregular about a lender taking into account genuine commercial interests when operating its business.

- LML did not exercise its discretion about how and when to vary the SVR unfairly. On each occasion that LML exercised its power to vary the SVR, it did so in accordance with the express terms of Miss C's mortgage contract, on the basis of proper and genuine commercial considerations and within the applicable regulatory parameters.

- LML only changed its SVR three times in the period between the end of Miss C's fixed interest period on 1 August 2010 and the redemption of her loan on 17 September 2019. Since the end of the fixed rate period, Miss C was, at all times, required to pay interest at a rate significantly lower than both the fixed rate (5.99%) and the SVR (6.84%) which were specified in the 2005 mortgage offer.

- LML's SVR has been comparable to the SVRs of other lenders. This demonstrates that Miss C will be unable to establish that LML set its SVR at a level no reasonable lender would have done.

- Data shows that the SVR margin increased across the board for mortgage lenders in the UK following the global financial crisis. This is not unexpected and does not give rise to concern or a claim for compensation.

- The arguments made by Miss C have been considered and not upheld by this service in a number of recent decisions relating to other borrowers. Case law dictates that this service should act in accordance with good decision-making principles: like cases be treated alike. There is nothing in the circumstances of Miss C's case that would justify it being treated differently from these prior decisions.

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

- LML 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.
- Miss C's mortgage contract did not commit to track the Bank of England Base Rate, she was made sufficiently aware of its terms and that LML has sought to charge interest in accordance with those terms.
- The SVR applied from March 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 LML 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 Miss C dissolving the contract, the investigator noted that LML was only able to rely on the variation terms when there was no ERC. So, Miss C would have only had to pay the discharge fee and other associated switching costs if she 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 Miss C's mortgage that may have made it more difficult for her to re-mortgage elsewhere. The unsecured loan had a 'de-linking premium' whereby she would have had to pay an additional rate of 5% on the unsecured loan if she moved the mortgage elsewhere but was 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 Miss C 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 Miss C experienced because of mortgage payments based on changes to the interest rate. And the need to consider whether LML 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 LML varied the rate unfairly.
- Between January 2008 and April 2009, the SVR only reduced – but the difference between the SVR and the base rate increased. The Investigator didn't think a term that reduces the rate, and therefore the amount of interest Miss C 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, Northern Rock required government assistance in the form of a loan during this time which it had to repay as quickly as possible.
- LML 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 LML 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 LML to track base rate, the investigator did not think that the changes to the interest rate in this period resulted in unfair treatment of Miss C.
- In 2016, the SVR reduced but not by as much as the Base Rate reduction. LML has explained that its own cost would only reduce enough to justify a 0.15% reduction. Based on the evidence he had seen, much of which is commercially sensitive, the investigator thought this decision was fair. The terms and conditions provided for the change and he was satisfied LML took account of the relevant factors he would expect a lender to take into account when making such a change.
- The SVR increased twice in 2018 following increases in Base Rate. LML explained the factors it took into account when making this change. It had considered the increases made to Base Rate in 2017 and 2018, the impact this had and was likely to have on its cost of funds and the subsequent trend of increasing interest rates in the UK market. It also took into account FCA guidance and its regulatory obligations.
- So, while the terms do provide LML with a significant amount of discretion in regard to when or whether to vary the SVR on Miss C's mortgage - the investigator didn't think this had resulted in Miss C being treated unfairly.

Miss C's representative responded to say it disagreed with the investigator's outcome and asked that the case be passed to an ombudsman for decision. In summary it said:

- In relation to the fairness of the SVR, and whether LML treated Miss C fairly, it provided independent, expert evidence which confirms that the cost of funds dropped following the financial crisis. This contradicts LML'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 LML, so neither it nor the expert are able to comment on or disprove it.

- The investigator has confirmed that Northern Rock'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 Northern Rock was not driven by a desire to repay that loan as quickly as possible, which required increasing its 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 Northern Rock 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.
- The considerations of negative equity, an unaffordable unsecured loan and the fact that the mortgage would be transferred to an inactive lender, without any obligation to set fair SVR rates, could not have been in the contemplation of Miss C, or other customers, at the outset. This is a central theme to the well-publicised concerns of mortgage prisoners.

LML responded to say it agreed with the ultimate conclusion reached by the investigator. But it disagreed with the findings in relation to the fairness of certain terMiss Contained in the General Conditions and the relevance of the interest rate potentially payable upon de-linking of Miss C's unsecured loan to assessing the fairness of the powers to vary the interest rate.

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

- Each time LML varied the interest rate, it was prompted by a change in the Bank of England Base Rate. But the amount by which LML 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 LML has sent us about the decision process behind the rate changes throughout the relevant period.
- The Government loan came with conditions and Northern Rock 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 Northern Rock'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 Northern Rock'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 LML and its predecessors 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.

LML chose to make further submissions in response to the investigator's notice that the case would be passed to an ombudsman to decide. In summary it said:

- LML agrees with the overall conclusion that it has not treated Miss C unfairly or unreasonably in the way it set and varied the interest rate on her mortgage, or applied interest to her mortgage account.
- However, it does not agree there is a basis in law to challenge the fairness of conditions 7.2 (b), (c), or (g) of the General Conditions applicable to Miss C's mortgage under UTCCR.

LML provided detailed analysis and reasoning to support its reasons for disagreeing with certain aspects of the investigators view. As much of this repeats and then builds on what I have set out above, I have not reproduced a summary of its analysis here.

Miss C's representatives did not provide any further submissions.

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

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 Miss C. But I hope the reasons I have set out below will help her to understand why I have come to this conclusion.

Miss C's representative has raised many individual complaint points both to LML directly and to this service. However, like the investigator, I consider the overall complaint to break down into two key points:

1. Miss C had an expectation that her mortgage would track the Bank of England Base Rate once it reverted to the variable rate. As it did not do so, LML has treated her unfairly.

2. LML 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 Miss C paying a higher rate of interest on her mortgage balance than she should have.

I will deal with each point in turn.

Did LML's' actions cause Miss C to have an expectation that her mortgage would track the Bank of England Base Rate?

Miss C's representative considers LML to have given Miss C a legitimate expectation that her mortgage would track base rate.

Our investigator concluded that this part of Miss C's complaint is out of time. Having reviewed the case, I agree with this finding.

To the extent that Miss C's representative is suggesting that this is also a basis to complain about the charges that are in time, I disagree with its conclusions.

The mortgage documentation is clear in that Miss C's mortgage would revert to the SVR once her fixed interest period expired and that the SVR could go up as well as down. And I haven't seen any evidence that persuades me that LML was obligated, contractually or otherwise, to have its SVR track Base Rate.

I am aware Miss C'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.

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

So, it follows that I do not uphold this part of Miss C'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:

The mortgage offer dated 8 June 2005 set out at Section 4:

"4. Description of this mortgage

This is a Northern Rock product

…

This secured mortgage is based on the following interest rate periods:

- *a fixed rate of 5.99% until 1 August 2010*

  followed by

- *a variable rate which is guaranteed to be below Northern Rock Standard Variable Rate, which is currently 6.84%, for the remainder of the term of the mortgage…"*

"12a. Northern Rock's additional mortgage requirements

Guaranteed Rate (Basket Rate)

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)…"

The mortgage offer dated 28 November 2007 set out at Section 4:

"4 Description of this mortgage

This is a Northern Rock product

…

Part 1 of this secured mortgage is based on the following interest rate periods:

a fixed rate of 5.99% until 01/08/10

followed by

a variable rate of 7.83% which will be reviewed monthly and is guaranteed to be less than Northern Rock's Standard Variable Rate for the life of the loan."

The mortgage offer dated 7 December 2012 set out at Section 4:

"4. Description of this mortgage

This mortgage is provided by Northern Rock (Asset Management) plc: TOG 5 Yr Fixed

This secured mortgage is based on the following interest rate periods:

- *a variable rate which is guaranteed to be at a discount below Northern Rock (Asset Management) plc's Standard Variable Rate, for the remainder of the term of the mortgage. The current Northern Rock (Asset Management) plc Standard Variable Rate is 4.79% with a variable discount currently 0.01%, giving a current rate payable of 4.78%…"*

"12a. Our additional mortgage requirements

Guaranteed Rate (Basket Rate)

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

(Asset Management) plc borrowers (the Guaranteed Rate)…"

The 2005 mortgage general conditions 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 in set out in the Offer. We may change this rate from time to time under condition 7 or 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 it 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 a 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)…"*

The 2009 general conditions repeat what I have set out above but also contain the addition of:

"7.2

(f) to reflect changes in laws, guidance or industry codes of practice or their interpretation or any decision of the court or any ombudsman or tribunal;

(g) to reflect changes in market conditions."

LML has told us it relied on Condition 7.1 for all reductions to the SVR and Condition 7.2 for the increases. It has also said it wrote to Miss C each time it varied her 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 Miss C'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 Miss C 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 Miss C (Regulation 8 UTCCR). And LML 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 Miss C'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 LML disagrees with my conclusion on this point. But as its objections do not change my overall outcome on the complaint, I am not going to comment on this point further.

- Do the terMiss Create a significant imbalance contrary to the requirements of good faith?

As set out above, one of the considerations when determining if the terMiss 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 Miss C'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 Miss C's agreement go further than reasonably necessary to protect LML's legitimate interests, whether the variation clauses are sufficiently transparent and whether there were significant barriers to Miss C 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 circumstances in which changes might be made give LML 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 LML 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…"

"(g) to reflect changes in market conditions"

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 is 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', 'a prudent level of profitability' and 'changes in market conditions' are very vague terms.

While I do think that a term enabling LML 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), (c) and (g) 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

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

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 Miss C dissolving the contract that she 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 Miss C at the point at which her 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 Miss C's mortgage at the point it reverted to the Guaranteed Rate on 1 August 2010. So if LML had exercised its rights as set by the variation term, and Miss C was unhappy with that decision, she was free under the contract to transfer her mortgage to another lender should she have wished without having to pay this charge.

Miss C's representative has said that other costs impacted on Miss C's ability to redeem her 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 her 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. Miss C would incur these costs if ever she 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 Miss C dissolving the contract should she have wanted to, I do think it was reasonably foreseeable that Miss C may struggle to refinance both her mortgage and the unsecured loan. Given the special conditions attached to the unsecured loan, I think this was a real and practical barrier to Miss C dissolving her mortgage contract with LML.

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 LML increased the SVR for an unclear reason, Miss C 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 LML 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 Miss C'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 Miss C'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 Miss C being treated unfairly.

Has LML 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 Miss C's mortgage since 12 March 2014. All interest charging events before that are out of time because Miss C did not refer her complaint to the Financial Ombudsman Service in time.

However, in order to consider the fairness of the interest Miss C was charged during the period that is in time, it's necessary for me to consider historic changes to LML's SVR, since the SVR charged during the period of time that is in time is the result not only of decisions LML made during that period, but also the result of decisions it made prior to it.

I'm satisfied that each time LML 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 12 March 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 March 2014 is itself unfair.

Having established that I need to look at the SVR both before and after 12 March 2014, and having considered all the available evidence, I am not persuaded LML has varied the rate unfairly. I have set out why below.

From the beginning of the mortgage in 2005 to January 2008, the changes to Miss C's SVR mirrored changes in Base Rate.

Between January 2008 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 LML was not contractually obligated to track the base rate. Nor is it the case that Miss C's mortgage had a 'cap' preventing LML'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 LML to reduce the SVR, and with it, the amount Miss C 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 the variation terms were exercised was fair.

As mentioned before, Miss C originally took her mortgage with Northern Rock, which was nationalised in 2008, becoming NRAM, so the majority of the information and evidence I have looked at for this period has been supplied by NRAM. But LML has also provided its own commentary for the period of the financial crisis.

The evidence LML and NRAM have provided to show how the SVR was reviewed over the relevant period, the decisions taken when it came to varying the rate and by how much as well as the general commercial strategy at the time is commercially sensitive. For reasons of commercial confidentiality, I haven't set out the evidence provided by LML or NRAM in full or provided copies of it to Miss C. 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 and LML have 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.

LML has set out that despite the Bank of England's decision to dramatically reduce interest rates, commercial entities still needed to set interest rates based on their own commercial considerations, including funding costs and assessments of lending risks.

It highlighted that an anticipated increase in future loan losses typically leads to an increased differential between a lender's costs of funding and the rate it charges, to price in those expected losses to cover its risks. During the credit crisis, lending risks dramatically increased due to the deterioration in the loan and borrower credit characteristics. This led to the risk of mortgage defaults and loan losses increasing.

NRAM has told us that, like many lenders at the time, it was predominately 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 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 Miss C'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 Miss C'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

---

[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

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's balanced its own financial position and obligations at the time with the impact such changes would have on customers like Miss C.

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 LML acted to protect its legitimate interests while balancing its obligation to treat Miss C fairly. And I'm further satisfied that the evidence LML 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 Miss C's representative, I am not persuaded it outweighs the business specific evidence provided by NRAM and LML 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.

In 2016, the Base Rate reduced by 0.25% and LML chose to pass on a 0.15% reduction to its SVR. LML has shown that its funding costs did reduce at this time, but not by the same amount that the Base Rate reduced. It has explained that in making this change it took into account actual and anticipated fluctuations in market interest rates, fluctuations in its funding arrangements, the desire to maintain a prudent level of profitability and obligations to commercial counterparties and its regulatory requirements. Having reviewed the evidence provided by LML, I am satisfied it exercised its contractual power to vary the SVR fairly. And I will restate that it was not obligated to mirror the falls in Base Rate.

LML increased its SVR twice in 2018 resulting in a total increase of 0.4%. These changes followed two Base Rate increases totalling 0.5%. It has told us that, in making the decision to increase its SVR, it took into account the increase in Base Rate, the actual and anticipated upward movements of LIBOR and the impact those had on its cost of funding, as well as its requirement to treat its customers fairly. Having done so, it decided to pass on a 0.15% interest in January 2018 and a 0.25% increase later that year. I'm satisfied it considered the relevant factors I'd expect a mortgage lender to take into account when deciding whether to increase the rate charged on its mortgages. As a result, I'm not persuaded the 2018 variations were made unfairly or outside of the terms and conditions provided for in Miss C's contract.

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

I have also considered the representative's point that LML 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 LML 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 LML 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 Miss C to accept or reject my decision before 6 March 2023.

Lucy Wilson
Ombudsman