DRN-4153977

The complaint

Mr K, who's represented by his solicitors, complains about the interest rate he's been charged on his mortgage with TSB Bank plc trading as Whistletree.

What happened

Mr K took out his mortgage with the former Northern Rock bank in 2007. He borrowed £80,000 over a term of 30 years on a repayment basis. The mortgage was on an initial interest rate of 5.89% for the first five years, reverting thereafter to Northern Rock's standard variable rate (SVR) from 1 February 2012.

Mr K also borrowed a linked unsecured loan of £7,000 on the same interest rate over the same term. For as long as Mr K retained the mortgage, he would be charged the same interest on the unsecured loan as on the mortgage. But if he ever repaid the mortgage without also repaying the unsecured loan, the interest rate on the unsecured loan would increase to 8% above the SVR.

In 2008, Northern Rock collapsed and was nationalised as part of the wider global financial crisis. Much of its mortgage business, including Mr K's loan, was transferred to a government-owned successor firm called NRAM.

NRAM was a closed book lender – meaning it held existing mortgages but did not seek out new business or lend to new customers. And it didn't offer new preferential rates to existing customers. So all customers – including Mr K – were required to remain on the SVR once their initial rate expired, unless they repaid their mortgage or moved to another lender.

Mr K remained with NRAM until his mortgage was transferred again, this time to TSB Bank plc. TSB acquired part of NRAM's mortgage book – it did so under the trading style Whistletree. Whistletree is merely a trading style and not a separate entity in its own right, and so TSB (trading as Whistletree) is now Mr K's lender and is responsible for answering this complaint.

For ease, I'll refer to the mortgages (including Mr K's) transferred from NRAM as the Whistletree book charging the Whistletree SVR, and the rest of TSB Bank plc's mortgage business as the TSB book charging the TSB SVR (or other reversion rates). And in talking about the regulated entity that owns both books, I'll refer to TSB Bank plc.

With the assistance of his solicitor, Mr K complained to Whistletree. He said:

- The mortgage offer did not explain what was meant by the "standard variable rate", and as a result Mr K was misled into believing that the rate would vary in accordance with the Bank of England base rate rather than at the lender's discretion.

- The terms and conditions were contained in a separate document to the mortgage offer and so not incorporated into the contract. And even if they were, it is unfair to expect a consumer to "pore over the small print" to understand a key term.

- The meaning of the SVR, and that it could be varied other than in accordance with base rate, should have been clearly explained in the mortgage offer. Not doing so means the interest rate section of the mortgage offer is unfair.

- The term of the mortgage contract enabling the lender to vary the interest rate was an unfair term within the meaning of the Unfair Terms in Consumer Contracts Regulations 1990 (UTCCR). It lacked transparency and caused a significant imbalance between Mr K and the lender.

- The reasons given in the contract allowing the SVR to be varied are vague and generalised and lack objective clarity, and are not written in plain language. This was a "completely unfettered power" to vary the SVR at will.

- Mr K didn't have an effective right to end the mortgage contract because of an early repayment charge (ERC) and the costs associated with redeeming this mortgage and taking out another.

- As an unfair term, the variation term is unenforceable and should be replaced with an implied term that the SVR should be set at a reasonable rate corresponding to the lender's cost of funds and not unconnected or external factors.

- As a result, the lenders breached Principle 6 of the regulator's rules, requiring a firm to pay due regard to the interests of its customers and treat them fairly, and to assess whether a mortgage would be affordable before entering into it.

- In redress, Mr K seeks the difference between what he would have been charged at a reasonable rate of interest and what he actually paid.

Whistletree responded to Mr K's complaint. It said:

- It did not agree that the term entitling it (and the predecessor lenders) to vary the interest rate was an unfair term. In any case it said it was a "core term" and thus excluded from any assessment of unfairness.

- It did not agree that the mortgage wasn't binding on Mr K.

- It did not agree it had acted in breach of the rules of mortgage regulation or the regulator's wider principles.

- Mr K had been fairly and lawfully charged the interest owing under his mortgage agreement.

- In any case, the complaint was out of time because it was brought more than six years after Mr K took out the mortgage.

As he wasn't satisfied with Whistletree's response, Mr K brought his complaint to our service. It was looked at by one of our investigators. At first, she dealt with the question of time limits. She said that she could only consider the fairness of interest charged within the six years leading up to Mr K's complaint – since he would have been aware (or ought reasonably to have been aware) of cause for complaint about interest charged before that at the time it was charged. That meant she would only consider the fairness of interest charged from 10 March 2014 onwards. And for the same reasons, the complaint about being misled about the nature of the SVR at the start of the mortgage was also out of time.

The investigator also said that in considering the fairness of interest charged in the six years

leading up to Mr K's complaint, she would need to take into account previous variations of the SVR which took place before that period. A complaint about those variations of themselves is out of time. But those variations may provide important context to explain why the SVR was charged at the level it was charged at during the period which was in time – since at any given time, the level of the SVR is the "sum of the parts" of its history leading up to that date. She was therefore satisfied that those matters were potentially relevant as part of all the circumstances of the case she would need to take into account in considering what was fair and reasonable during the period that was in time.

Mr K's representatives accepted the investigator's conclusions on jurisdiction. Whistletree did not ask for them to be reviewed by an ombudsman. So our investigator went on to consider the merits of that part of Mr K's complaint she said had been brought in time. In summary, she concluded:

- The mortgage offer and terms and conditions did not suggest that the SVR was linked to or tracked the Bank of England base rate. And therefore it was not unfair that the SVR had not been set, or varied, solely by reference to base rate.

- Northern Rock's general mortgage conditions formed part of the mortgage contract agreed by Mr K. The conditions set out when the SVR could be varied.

- Whether or not the SVR term was a fair term is ultimately a question for the courts. But the fairness of the term is nevertheless relevant law to be taken into account. And the investigator noted that in her view it was arguable that the term lacked transparency and was drafted in such a way to give the lender broad discretion to vary the SVR. She also noted that Mr K had a linked unsecured loan on which – if the mortgage was ever repaid – the interest rate would rise to 8% above the SVR. She thought this might amount to a practical barrier, foreseeable at the time of the sale, constraining Mr K's ability to move his mortgage elsewhere if he was unhappy with the exercise of the term.

- But she noted that the key question was whether Whistletree or its predecessors had ever used the SVR variation term in a way that resulted in unfairness to Mr K within the six years that she could consider.

- To that end, she considered whether, when the term had been exercised, there were legitimate reasons for Whistletree or its predecessors to vary the SVR in the way they did.

- She noted that prior to 2012 Mr K was on a fixed rate and his interest rate was not related to the SVR. Between 2007 when the mortgage was taken out and 2012, Northern Rock and NRAM had only reduced the SVR. Though over this time the margin between the SVR and base rate increased – because the SVR did not reduce to the same extent base rate reduced – she was satisfied that this was not an arbitrary decision or that it amounted to "profiteering", as Mr K's representatives had alleged. Rather, she was persuaded that while Northern Rock and then NRAM's costs reduced over this period, those costs were not directly linked to base rate and did not reduce to the extent base rate reduced. The decisions to reduce the SVR, and to reduce only to the extent that it was reduced, were legitimate decisions and did not result in an SVR that was disproportionate compared to the range of SVRs in the wider mortgage market.

- After Mr K reverted to a rate linked to the SVR, in 2012, there were no further SVR variations prior to the transfer to Whistletree in 2016.

- Since Whistletree took over Mr K's mortgage, it has only varied the SVR at the same time as, and by the same amount as, changes in Bank of England base rate.

- She noted that Whistletree had shown that its own funding costs were linked to LIBOR, and later to SONIA. While LIBOR and SONIA are not directly linked to base rate, and so Whistletree's costs were not directly linked to base rate, movements in LIBOR and then SONIA broadly corresponded with changes in base rate over this period. She was satisfied that the changes since 2016 were made in line with the terms and conditions and that Whistletree had acted fairly and reasonably.

Mr K and his representatives didn't accept what our investigator said, and asked for the complaint to be reviewed by an ombudsman. In summary, Mr K's representatives said:

- The fact that the loan was transferred to an inactive lender, and that the unsecured loan might leave him in negative equity, could not have been contemplated by Mr K at the start of the loan, but are relevant to the assessment of fairness.

- If NRAM's funding was related to the government loan, it seems likely that it was an imperative for NRAM to repay that loan as quickly as possible – which in turn drove it to set and maintain its SVR above the "industry norm", and significantly above base rate. This can only be "profiteering". The SVR was set to increase NRAM's profits at the expense of its customers.

Mr K's representatives also raised a further matter for consideration:

- Even if the NRAM SVR was justified by the costs of the government loan, that cannot have applied following the transfer to Whistletree as a private company which did not owe the government loan.

- When the mortgage was transferred from NRAM to Whistletree in 2016, the NRAM SVR was 4.79%. At the same time, the TSB SVR was substantially lower. Acting fairly, TSB should have charged Whistletree customers such as Mr K the same SVR as it charged its other customers, rather than maintaining them on the same SVR it inherited from NRAM.

- This meant that Mr K paid a higher rate of interest than he would have done had TSB equalised the Whistletree and TSB SVRs. Where one bank treats two groups of customers in different ways, that cannot be because of the bank's cost of funding, which must be the same for both groups of customers. Similarly the bank's prudential obligations to hold funds do not vary for different groups of customers.

- It should be assessed whether the SVR was fair on transfer. At this time interest rates were not increasing, there was no government loan owed by Whistletree, and the factors relating to the global financial crisis were long in the past.

- Clause 7 of Northern Rock's general mortgage conditions, which the investigator cited, cannot be relevant. Those terms were only ever intended to relate to Northern Rock, and therefore "ceased to have any contractual application or practical relevance" following the transfer of the mortgage.

- As is clear from the TSB SVR, the way TSB Bank plc – including Whistletree – operated was very different from Northern Rock and NRAM. And so even if the SVR was set according to the need for "a prudent level of profitability" or for "good commercial reasons", the Whistletree SVR should have been set at the same level as the TSB SVR.

- The focus should therefore not just be on the SVR variations carried out by Northern Rock and NRAM – but also on Whistletree's failure to vary the SVR. There was no justification for continuing to maintain the SVR at a margin of 4.29% above base rate when the reasons for setting it at that margin no longer applied by virtue of the transfer to Whistletree.

- In those circumstances, in maintaining the SVR at such a high level Whistletree was acting in breach of express and implied terms of the mortgage contract. And this did not result in fair treatment of Mr K.

In response to these further arguments, Whistletree said:

- It is not correct to say that the two groups of customers – Whistletree and TSB – are the same and must be treated in the same way. There is no requirement for all customers of a firm to be charged the same interest rate and there are many examples of firms that have distinct books of mortgages, with distinct rates, within the firm.

- Since acquiring Mr K's mortgage, Whistletree has only varied the SVR to reflect changes in base rate – and changes to the Whistletree SVR were made at the same time, and by the same amount, as changes to the Bank of England base rate.

- The starting point was inherited by Whistletree on the transfer. The investigator found that NRAM had acted fairly in setting the SVR at that level.

- It is not correct to say that the Northern Rock General Conditions no longer apply. The terms and conditions continue to apply after a transfer. The existing contract was assigned to TSB Bank plc but otherwise continued on the same terms. There is no requirement to review the SVR on transfer, and the relevant question is whether, when making further variations, Whistletree acted in accordance with the terms and conditions. In maintaining the SVR at the same level as at acquisition, until it was entitled to vary it under the terms and conditions, Whistletree acted in accordance with the contract and acted fairly.

- TSB Bank plc manages its costs of funds at bank level and does not separate out its costs as between the TSB and Whistletree books. However, cost of funds is not the only factor relevant to the level of the SVR and there are other differences between the two books.

- These differences include:

    - The Whistletree book has a higher overall credit risk and default risk than the TSB book. It is reasonable to reflect this higher risk in the level of the SVRs charged by the two books.

    - The Whistletree book has, on average, higher loan to values than the TSB book. This and other factors mean that TSB Bank plc has to hold proportionately higher capital in respect of Whistletree mortgages than it does in respect of TSB mortgages to comply with its prudential obligations. It is reasonable to reflect the higher cost of capital in the level of the SVRs charged by the two books.

    - The Whistletree book is not managed by TSB Bank plc directly. It outsources the administration of the loans to the same third party administrator that managed them on behalf of NRAM, providing continuity. It is reasonable to

reflect the different costs of administering the two books in the level of the SVRs the two books charge.

- TSB Bank plc did not review the SVR on acquisition and re-set it anew, it simply maintained Mr K's mortgage on its existing terms and conditions including interest rate. But had it done so, those differences would in any case have justified setting the Whistletree SVR at a higher level than the TSB SVR.

- For all those reasons, the TSB SVR is not relevant to whether the Whistletree SVR, leading to the rate Mr K was charged, is a fair rate.

My provisional decision

I issued a provisional decision setting out my thoughts on the case. In brief summary, I said:

- Under the time limit rules applying to the Financial Ombudsman Service, I could only consider the fairness of interest charged since 10 March 2014 – though in doing so it would be necessary to consider the impact of events before that date on the fairness of interest charged after that date as part of all the circumstances of the case.

- Both the mortgage offer and the general terms and conditions formed part of the mortgage contract.

- The term allowing the successive lenders to vary the SVR was set out in the terms and conditions.

- While a court may consider parts of contractual terms allowing the SVR to be varied to be unfair, it is also necessary for me to consider how the term has been used in practice, and whether that has resulted in unfairness to Mr K.

- I was not persuaded that the term had been exercised in such a way that resulted in unfairness to Mr K between 10 March 2014 and the date of transfer to Whistletree.

- I was satisfied that Whistletree had shown there was good reason why it chose to maintain the rate charged to Mr K at a level equivalent to the NRAM SVR (plus discount) rather than reducing it to the TSB SVR.

- I was satisfied that the variations to the SVR since the transfer to Whistletree had not resulted in unfairness to Mr K.

- I therefore said that I was not minded to uphold Mr K's complaint.

The responses to my provisional decision

Mr K's representatives had no further arguments to make. Whistletree said that it agreed with the overall outcome, but that it did not agree with certain specific parts of my provisional decision. In particular, it said:

- It continued to disagree that the SVR variation term was assessable for fairness under the UTCCRs. And, in any case, since I had ultimately decided Mr K's complaint on broader questions of fairness, it was not necessary for me to "speculate" on what a court might or might not conclude on such a complex legal question. It also did not consider I had reached a view consistent with what other ombudsmen had said in other cases.

- There is no single TSB SVR – TSB operates a range of reversion rates.
- Since the transfer, Whistletree had only varied the SVR to the same extent as changes to base rate.

What I've decided – and why

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

I've considered what the parties have said in response to my provisional decision, and having done so I see no reason to change my mind – either as to the overall outcome, or as to the reasons for it. My final conclusions are therefore largely the same as my provisional conclusions. But in what follows I will, where relevant, address the further matters Whistletree has put forward.

I'm aware that TSB has a range of reversion rates. For residential mortgages, it has the Homeowner Variable Rate, the Follow-On Tracker Rate, and the Standard Variable Mortgage Rate (SVR), as well as a separate reversion rate for buy to let mortgages. However, in my provisional decision I referred, and in what follows I'll refer, to the TSB SVR – because Mr K's representatives referred specifically to TSB's SVR as the rate with which the Whistletree SVR should have been harmonised. The SVR is the lowest of the three residential reversion rates TSB operates. But my conclusions are equally applicable to whether Whistletree ought to have aligned its SVR with any of TSB's other reversion rates.

The relevant terms and conditions applicable to this mortgage

When Mr K took out his mortgage in 2007, he was issued with a mortgage offer and a copy of Northern Rock's general mortgage conditions.

Section 4 of the mortgage offer says:

> *This secured mortgage is based on the following interest rate periods:*
>
> - *a fixed rate of 5.89% until 1 February 2012*
>
> *followed by*
>
> - *a variable rate which is guaranteed to be below Northern Rock Standard Variable Rate, which is currently 7.34%, for the remainder of the term of the mortgage.*
>
> *If Northern Rock's standard variable rate changes, we will review the interest rate applicable to your mortgage on the first working day of the following month. We will then notify you in writing of your new interest rate and payment, which will take effect from the first day of the month following the review.*
>
> *We will follow this procedure whether Northern Rock's standard variable rate rises or falls.*
>
> *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.*

Although Mr K's mortgage is on a rate "guaranteed to be below" the SVR, in practice it's

been set at 0.01% below the SVR. For ease, I'll refer to the SVR in this decision as following the end of the fixed rate it's the SVR – and any changes to it the lenders may or may not have been entitled to make – which determined the interest rate applicable to Mr K's mortgage.

Edition 3 of Northern Rock's Mortgage General Conditions, section 7 says

> ***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 of 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.*

"Standard Variable Rate" is defined in section 1 as

> *… 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 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 under condition 7 or the Offer.*

Mr K's representative says that the general conditions document is not of "any contractual application or practical relevance" to his mortgage following the transfer away from Northern Rock, since these are specifically Northern Rock's standard mortgage conditions and therefore ceased to apply when Northern Rock was no longer his lender.

I don't agree about that. It doesn't seem to me to be compatible with the general principles under which a party may assign the benefit of a contract to which it is party to someone else – which involves the assignee taking over the contract on the same terms and conditions.

And in any case, this is specifically provided for in the terms and conditions.

Section 1.1 (a) says

"we", "us" and "our" refer to Northern Rock plc and anyone who becomes entitled at law or in equity to any of our rights under the Offer (this will include any person to whom we transfer the Offer under condition 19)

Section 19 says

19.1 We may transfer or change or otherwise dispose of the Offer or any of our rights under the offer (including the right to set the Interest Rate) to any person at any time at law or in equity without your consent. Where we transfer to any person the right to set the Interest Rate, that person may set the interest charged under the Offer by reference to that person's own (or one of its own) standard variable rates.

In agreeing to this mortgage, therefore, Mr K agreed that Northern Rock could transfer the mortgage on to another lender. This happened when it was transferred to NRAM, and again when it was transferred to Whistletree. On both occasions, the mortgage terms and conditions continued as before, except that the new lender not Northern Rock was now the counterparty.

Mr K's representative has also suggested that the general conditions don't apply in any case because they were set out in a separate document to the mortgage offer – and that the mortgage offer itself is the only contractual document.

But I don't agree about that. There's no obligation to include all the terms and conditions of a contract in a single document. And, in cases such as this where there are bespoke elements specific to Mr K – such as the amount lent and term of the lending – and generic elements applicable to all customers, it's not unreasonable for there to be two separate documents each forming part of the overall contract.

I'm also not persuaded that it's unreasonable for the successive lenders to rely on the general conditions because they were "small print" that Mr K couldn't have been expected to read. A mortgage is a substantial commitment – one of the largest commitments many people will ever make – and it's reasonable to expect a borrower to read all the relevant documentation before agreeing to be bound by it. I'm satisfied it's reasonable to expect Mr K to have read them, and to treat him as if he had done so and was bound by both the offer and the general conditions, whether or not he actually did so.

For all those reasons, I'm satisfied that both the mortgage offer and the general conditions are part of the terms and conditions of Mr K's mortgage, and both are relevant matters for me to take into account in determining whether the SVR was set in line with the terms and conditions and set fairly and reasonably in the period I can consider.

The history of the SVR

The table below sets the history of the SVR for the life of Mr K's mortgage until he made this complaint – though it should be noted that Mr K was on a fixed rate until 2012, and it was only after reversion that the interest rate he was charged became linked to the SVR at all.

But nonetheless all changes since inception of the mortgage are given below, on the basis that the cumulative effect of those changes led to the SVR being set at the level it was on reversion.

Date	Base rate	SVR*	Difference between base rate and SVR
01/08/2007	5.75%	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	5.00%		
01/05/2008		7.49%	2.49%
08/10/2008	4.50%		
01/11/2008		7.34%	2.84%
06/11/2008	3.00%		
01/12/2008		5.84%	2.84%
04/12/2008	2.00%		
01/01/2009		5.34%	3.34%
08/01/2009	1.50%		
01/02/2009		5.09%	3.59%
05/02/2009	1.00%		
01/03/2009		4.79%	3.79%
05/03/2009	0.50%		
01/04/2009		4.79%	4.29%
Mr K was on a fixed rate until 1 February 2012 when he reverted to a rate 0.01% below the 4.79% SVR - so paying 4.78% thereafter. There were no further changes to the SVR while NRAM owned the loan. *Mr K's mortgage was transferred to Whistletree in July 2016. The SVR continued to be 4.79% following the transfer, and Mr K continued to be charged 4.78%, until Whistletree further varied the SVR later in 2016.*			
04/08/2016	0.25%		
01/10/2016		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%
11/03/2020	0.50%		
19/03/2020	0.10%		
01/04/2020		4.39%	4.29%

**At all times he was not subject to a fixed rate, Mr K was paying 0.01% below the SVR*

Was NRAM and then Whistletree under a contractual obligation to charge Mr K an interest rate that tracked the Bank of England base rate?

Mr K has complained that he was misled when he took out the mortgage, and was led to believe that the SVR would track the Bank of England base rate at the same margin as was the case at inception of the mortgage in 2007.

I've explained that this part of the complaint is out of time. But I can consider whether, in the period I am considering, NRAM and then Whistletree were under an obligation to charge an SVR that tracked the Bank of England base rate, whether at the margin that applied at inception or otherwise.

In the period I can consider from 10 March 2014, as the table above shows, the SVR did in fact track base rate – in the sense that NRAM and Whistletree only varied it at the same time as, and to the same extent as, base rate changed. But the margin between the SVR and base rate was 4.29%, compared to 2.09% at inception.

I think the mortgage offer is written in clear and intelligible language. It makes clear that the SVR is a variable rate – that the lenders are entitled to vary it – and there's no suggestion that the SVR is linked to the Bank of England base rate or any other external reference rate. It also makes clear that payment information for the period after reversion in 2012 is based on the SVR at the time of reversion – which might be different from what was set out in the offer.

We've found that any complaint that Mr K was misled into taking the mortgage in the belief that it was linked to base rate is out of time. But in determining the fairness of the interest rate charged during the period of time I can consider, I'm also satisfied that there is nothing in the mortgage offer that compels the lender to link the SVR to base rate or suggests that it would do so. Nor is there anything that suggests that the SVR would always be a particular margin above base rate.

Section 7 of the general conditions says that the lender may increase the SVR if there has been (or is reasonably expected to be) a "general trend to increase interest rates on mortgages generally or mortgages similar to yours". But this again does not say that the mortgage is linked to base rate, will always be set by reference to base rate, or will always be a particular margin above base rate.

I am satisfied that the SVR is not a tracker rate and that there is no obligation on the successive lenders to set the SVR by reference to Bank of England base rate, or to maintain the SVR at any particular margin over base rate. Nor is there anything that could reasonably have given Mr K the expectation that this would happen. It follows that I don't uphold this part of his complaint.

That being the case, the successive lenders were entitled under the terms and conditions to vary the SVR independently of base rate. In considering whether – in the period I can consider – they did so fairly and reasonably, I must next consider the relevant law relating to whether the SVR variation term is a fair term.

The fairness of the SVR variation term

I've set out the relevant terms above. In considering whether the variation term is a fair term, I've taken into account the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR), which was the relevant law at this time and applicable to this contract. While the application of the UTCCR is ultimately a matter for the courts, they are relevant law and so a relevant consideration I must take into account in determining what is fair and reasonable in all the circumstances of this case.

In response to my provisional decision, Whistletree said that it wasn't necessary for me to consider this question, since I had ultimately decided the case on fairness more generally. But I don't agree about that. This is a specific part of Mr K's complaint as put forward by his representative. And under our rules, I'm required to take into account – among other things – relevant law. In considering whether one party to a contract has acted fairly or in line with the terms and conditions, the fairness of the term relied on is relevant law. It's therefore necessary for me to take it into account.

I also don't agree that doing so amounts to "speculation" about what a court might decide. In order to consider whether the law is relevant to this complaint and if so to take it into account, I must first set out my understanding of what the law is. Questions of law are ultimately matters for the courts – but under our rules I am required to take relevant law into account. In this case, both the relevance and the application – if relevant – of the law to the terms of the mortgage contract is in dispute. While such disputes are ultimately matters for the courts to resolve, in order for me to take into account relevant law, therefore, it is

necessary for me to consider what a court might find when presented with that dispute. In my view, that's not "speculation" – it's a necessary part of understanding what the relevant law is so that I may take it into account appropriately.

The relevant law

Regulation 5(1) says:

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

Regulation 6 says:

> *(1) ... the unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.*

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

Mr K's representative says I should also take into account that his mortgage was later transferred to an inactive lender. But I don't agree – I don't think it was reasonably foreseeable at the time the mortgage was taken out that Northern Rock would later collapse and be nationalized.

> *(2) In so far as it is in plain intelligible language, the assessment of fairness of a term shall not relate -*
>
> *(a) To the definition of the main subject matter of the contract, or*
>
> *(b) To the adequacy of the price or remuneration, as against the goods or services supplied in exchange.*

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

> *1. Terms which have the object and effect of-*
>
> *(j) enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract…*

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

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

Regulation 8 sets out the remedy were a court to find a contract term unfair. It says:

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

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

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

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

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

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

The Court said that:

- the test for establishing a significant imbalance includes, but is not limited to, asking whether the terms of the agreement deprive the consumer of an advantage which they would enjoy under national law in the absence of the contractual provision;

- the question of whether a term is contrary to the requirements of good faith depends on an objective hypothetical negotiation, asking whether an informed consumer would have agreed to the term in question during individual contract negotiations. This should take into account a wider circumstantial review, such as the relationship with other relevant contractual terms; and

- consideration should be given to the nature of the goods or services supplied, including the significance, purpose and effect of the term in question.

FCA guidance (FG18/07) on unfair terms in consumer contracts says

> *‘The fairness assessment is a holistic assessment and these two elements may overlap in the way they apply to any particular set of facts’*

and that the applicable law

'recognises the importance of striking a fair balance between the legitimate interests of both the supplier and consumer.'

That means that the seller or supplier may be able to show they've acted in good faith where they can show they've taken the consumers' legitimate interests into account. That guidance also provides an overview of factors relevant to determining whether or not a variation term is fair. Although it applies to the Consumer Rights Act 2015 (which is the successor legislation to the UTCCRs) I am satisfied that these factors – which I discuss further below – are relevant to this assessment.

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

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

Transparency: In Kasler (Case C- 26/13) the CJEU considered the meaning of 'plain intelligible language' in the context of terms in a loan agreement. It said that the requirement of transparency must be understood in a broad sense. A term which has the effect of increasing the cost at the consumer's expense didn't just have to be formally and grammatically correct, but the reason for and particularities of a variation term have to be clear and intelligible. So does the term's relationship with other terms in the contract, relating to the advance of the loan. This is so the average consumer is aware of the variation term and can assess the potential economic consequences for them which might derive from it.

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

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

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

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

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

Application of the relevant law to this complaint

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

- Whether the term is a core term

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

I have reminded myself that the decision whether a term is unfair should be made in light of what sort of contract is in issue and what the contract is about, as well as what the other terms say and all the circumstances that existed when the term was agreed. Assessing whether a term is unfair involves winding the clock back to the date the term was agreed, and then as it were "standing back" to consider the term in its full context, both within the contract and in all the surrounding circumstances.

Core term: Properly understood, the variation clause relates to the mechanism for amending the price of the services provided, rather than the price itself. In Invitel the CJEU took a similar view. It is therefore an ancillary term whose fairness can be assessed under the applicable fair terms legislation. Whistletree has said that section 7 is a core term which cannot be assessed for fairness. But I don't agree about that. The SVR variation term does not go to the main subject matter of the contract or the adequacy of remuneration. It does not set the price; it provides a mechanism for amending the price set elsewhere in the contract.

So I've gone on to consider whether the term creates a significant imbalance in the rights and obligations of the parties contrary to the requirements of good faith.

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

- Whether the terms deprive consumers of an advantage they would enjoy under national law in the absence of the terms;

- Whether the terms go further than is reasonably necessary to protect the lender's

legitimate interests and whether the lender, dealing equitably and fairly with a consumer, could reasonably assume that the average consumer would have agreed to the term in hypothetical individual contract negotiations;

- Whether there were significant practical barriers to dissolving the agreement that may show unfairness.

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

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

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

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

Reversion rates serve a legitimate purpose in permitting lenders to provide for future changes that justify increases in the rate, and a lender's own costs of funds are by nature difficult to foresee. There may be other factors relevant to the price which vary over time – such as the risk of default or arrears. This is particularly true of a long term arrangement such as a mortgage contract.

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

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

Taking all that into account, I think there's a real possibility a court may conclude that the variation term does not meet the transparency requirement. While it's grammatically clear and easy to follow, the term is broad and gives the successive lenders significant scope for

discretion about when the SVR can be varied and by how much.

Section 7.1 allows reductions to the SVR for any reason, and is therefore the broadest part of the term. But because this creates an unfettered ability to reduce the interest rate payable, I don't consider this clause creates a significant imbalance to the detriment of the consumer contrary to the requirements of good faith – because while there are no restrictions on the lender's power to reduce the interest rate, doing so is in the consumer's favour and the absence of restrictions increases the circumstances in which Mr K might benefit from a reduction in his interest rate. But I consider the way the term is exercised could potentially lead to unfairness in individual cases.

Section 7.2 contains the following provisions, allowing the lender to increase the SVR:

- "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"

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

- "we wish to adjust our interest rate structure to maintain a prudent level of profitability"

- "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"

I think there's a real possibility a court might find that some of these clauses are not sufficiently transparent such that an informed consumer would have agreed to them in a hypothetical individual negotiation. They give the lender a broad discretion, and may enable it to take into account possibly irrelevant factors – for example, a general increase in shortfall risk on mortgage accounts owned by other lenders in respect of borrowers not similar to this borrower, or general trends in the market that aren't relevant to the lender's own costs. I'm not persuaded such a consumer would necessarily be able to understand the mechanism for any decision taken in reliance on these clauses, or be able to understand the economic consequences of agreeing to them. Nor would such a customer be able easily to challenge an increase made in reliance on them.

I've said there's a legitimate purpose in variable reversion rates, such as an SVR, in allowing a lender to vary the price of the agreement to reflect changes in its costs, credit risk, and other factors. But these clauses seem to me to be wider than reasonably necessary to achieve that purpose. And they do not explain to the consumer the method for determining the new price. "Good commercial reasons" and "prudent level of profitability" are vague and unclear, and it is not immediately apparent why shortfalls on dissimilar mortgages owned by other lenders are relevant to this lender's risk position.

For those reasons, while a term enabling the lenders to increase the SVR to reflect increases in cost of funds or other legitimate factors would in principle be a fair term, I think parts of section 7.2 specifically go beyond what national law would imply into a contract such as this. I think there's a real possibility a court would find that this section causes a significant imbalance between the parties and that it's unlikely a hypothetical consumer would have agreed to a term that allowed the lender such a broad and undefined discretion to increase the SVR.

I have also considered whether – at the time the contract was taken out – there were likely to

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

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

There was no early repayment charge (ERC) applicable to Mr K's mortgage whilst he was on the SVR. So when NRAM and Whistletree exercised their rights to vary the SVR after February 2012, if Mr K was unhappy with that decision, he was free under the contract to transfer the mortgage to another lender if he wished without having to pay a charge to end the existing contract with either lender. And similarly he was free to do so if he was unhappy with the level of the SVR at the point of reversion because of variations up to that point.

Mr K's representative has said that in practice Mr K wasn't free to exit the agreement. This is because of the costs associated with ending this mortgage and taking out another. I'm not persuaded by this. There is a relatively small exit fee, payable whenever the mortgage comes to an end to cover the lender's administrative costs. But I don't consider this amounts to a significant barrier. And I don't think the costs another lender might apply to an application Mr K might make are the sort of costs to be considered here either. These costs are not set by Northern Rock or its successors and are part of any mortgage application.

However, Mr K had an unsecured loan stapled to the mortgage. If he moved his mortgage elsewhere, the interest rate on the unsecured loan would increase to 8% above the SVR. Although in Mr K's particular case the unsecured loan was relatively small – around £7,000 at the start, reducing over time – that is in the context of a low property value and high loan to value on the mortgage itself. Mr K borrowed £80,000 on the mortgage, with a property purchase price of £88,000. The mortgage was therefore at 91% loan to value, and factoring in the unsecured loan he borrowed 99% of the property's purchase price. Given that, I think the unsecured loan may have represented a real and practical barrier to Mr K dissolving the mortgage contract.

My conclusion on the fairness of the term

Having considered the relevant regulations and caselaw, I think there's a real possibility a court would find that elements of section 7.2 are unfair. They lack transparency, appear to go beyond what is reasonably necessary, and there was a real risk (foreseeable at the time the contract was taken out) that Mr K may not realistically have been able to exit the agreement.

As a matter of law, the effect of a term being unfair is that it wouldn't apply. Mr K's representative says that this is an unfair term, and that it should be replaced with a term requiring a "reasonable rate" pursuant to s15 of the Supply of Goods and Services Act.

But I am required to determine this complaint by reference to what I consider to be fair and reasonable in all the circumstances. In doing so I must take into account – but need not be constrained by – the relevant law. The presence of a potentially unfair term doesn't necessarily mean that there has been actual unfairness such that I should uphold the complaint. In order to decide that, I need to consider not just the fairness of the term, but also whether it was exercised in a way that resulted in unfairness in the period I can

consider.

So while I have taken account of the relevant law, I've also thought more broadly about whether the way the term has been used has resulted in Mr K being treated in a way that was not fair and reasonable in all the circumstances. It is that question I will focus on next – considering first the times when the successive lenders relied on the variation term, and then the separate question of whether Whistletree should have (but did not) reduced the SVR to align with TSB's SVR on acquisition of Mr K's loan.

Did Northern Rock and NRAM exercise the variation term fairly?

I remind myself that the only part of this complaint I can consider is the fairness of interest charged to Mr K since 10 March 2014. The complaint about interest charged before that date – including any decisions to vary the interest rate – is out of time for the reasons given above.

However, those decisions are important context for the period I can consider. That's because the level of the SVR during the period I can consider is the product not only of decisions to vary it during that period, but earlier decisions in the out of time period. To that extent, those earlier decisions are important context for the period I am considering, and form part of "all the circumstances of the case" that I am required by our rules to consider when determining the part of the complaint that is in time. I'm satisfied that this approach is required of me by our rules, and is compatible with a recent decision of the High Court[1] on this question.

It's clear that each time NRAM made a decision to vary the SVR, the SVR remained at that level until the next time it decided to vary the SVR. And in turn NRAM's decisions led to the SVR Whistletree applied at transfer, until it later varied the SVR (whether it was fair for Whistletree to do that is also part of this complaint, and something I'll consider below – for now, I merely note that this was as a matter of fact what happened).

This means that the SVR as it was on 10 March 2014, at the start of the period I can consider, was the "sum of the parts" of what went before. And therefore if any of those earlier decisions were made for reasons not permitted by the terms of the mortgage agreement, or in reliance on a potentially unfair term, that might mean that it was unfair for them to be relied on as contributing to the level of the SVR (and therefore the interest charged to Mr K) during the period I can consider.

With that in mind, I've carefully considered all the evidence about NRAM's decisions to vary the SVR in the period leading up to March 2014.

As I've set out above, there were no variations after Mr K reverted to the discounted SVR rate in February 2012 while the loan remained with NRAM. All the variations to the SVR after the mortgage was taken out were while Mr K was on a fixed rate, and therefore they did not directly affect what he was required to pay. And all those variations reduced the SVR, so that at the time Mr K reverted to the discounted SVR rate, that rate was substantially less than the illustration contained in the mortgage offer.

I've already explained that the SVR was not a tracker rate, linked to the Bank of England base rate. NRAM was under no obligation to reduce the SVR at the same time and to the same extent as base rate reduced – and, as I've said, nothing in the mortgage documents could have given Mr K a reasonable expectation that it would do so.

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[1] *Mortgage Agency Services Number Five Limited, R (On the Application Of) v Financial Ombudsman Service Limited* [2022] EWHC 1979 (Admin)

However, Mr K's representative points out that while the SVR reduced, it did not reduce to the same extent as base rate – such that the margin between base rate and the SVR increased from 2.09% to 4.29% while Mr K was on his fixed rate. And this in turn meant that instead of reverting to a discounted SVR rate 2.08% above base rate, Mr K reverted to a discounted SVR rate 4.28% above base rate.

And while I've said that there is a real possibility that a court might find the specific SVR variation term in Northern Rock's General Conditions Edition 3 to be an unfair term as drafted, I don't think that a term allowing a mortgage lender to vary (including to reduce) its SVR is unfair in principle. I think the relevant question is therefore whether NRAM exercised its powers to reduce the SVR fairly.

We have received evidence about how the SVR was reviewed over time, and the decisions Northern Rock and NRAM took from time to time to reduce it, as well as evidence about NRAM's broader circumstances and commercial strategy at the time which form the context in which it took those decisions. DISP 3.5.9 R (2) permits me to receive information in confidence where appropriate, such that only an edited version, summary or description is disclosed to the other party. In this case, I consider that to be appropriate and so we have not shared that evidence with Mr K or his representatives. But I will summarise it in this part of my decision.

The relevant period is from late 2007 to early 2009, when the Bank of England base rate fell sharply, and to record lows, during the global financial crisis. At the same time, the UK mortgage market was going through a period of significant change and upheaval. The funding model of mortgage lenders changed at this time, as did the prudential and regulatory requirements imposed on them. There were many factors at play influencing the costs faced by mortgage lenders, not directly linked to base rate. For example, the Bank of England has said:[2]

> *"Prior to the 2007–08 financial crisis, bank funding costs largely moved in line with 'risk-free' interest rates set by central banks, such as Bank Rate in the United Kingdom — the rate paid on reserves held by commercial banks at the Bank of England. In this environment, movements in risk-free rates provided a reasonably good guide to assessing both the transmission of monetary policy and changes in the profitability of banks. All of this changed with the onset of the financial crisis, however. Some sources of funding evaporated rapidly. And measures of bank funding costs rose sharply relative to risk-free rates. There was a sharp increase in a range of funding 'spreads' — the difference between funding costs and the risk-free rate — during the period from 2007 to 2011. This range has since fallen back somewhat but remains higher than in the period prior to the crisis.""*

The evidence I've seen shows that Northern Rock's mortgage lending business was largely funded by wholesale funding, the cost of which was defined by reference to LIBOR rather than base rate. Before the financial crisis, LIBOR generally followed base rate – and so changes to LIBOR tended to take place broadly in line with changes to base rate, and so changes to base rate tended to be reflected in changes to cost of funding. And the same was largely true of Northern Rock's retail funding streams, which also contributed to its mortgage lending business.

However, during the financial crisis, there was an increasing disconnect between base rate and LIBOR – with the result that reductions in base rate were not matched by reductions to

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[2] Quarterly Bulletin, Q4 2014, Bank of England - https://www.bankofengland.co.uk//media/boe/files/quarterly-bulletin/2014/bank-funding-costs-what-are-they-what-determines-them-and-why-do-they-matter.pdf

the same extent in LIBOR or cost of funding. Access to wholesale funding became harder and more expensive as wholesale funders became more concerned by risk of default – meaning that where funding was available, margins over LIBOR increased even as LIBOR itself decreased. At this time Northern Rock's credit rating was impaired, and it became increasingly difficult for it to raise and service its wholesale funding. At the same time, it saw a substantial reduction in the retail deposits it held as customers moved elsewhere.

Northern Rock received a government loan in September 2017 to try to avert its collapse. There were conditions attached to the loan which impacted Northern Rock's wider strategy and cost of funds. Then in February 2008, Northern Rock was nationalised and restructured. Following the nationalisation, as part of state aid rules, there were limits placed on the size and scope of the business. Assets – such as parts of its loan book – perceived to be higher quality (in risk and prudential terms) were transferred to the private sector and those perceived to be lower quality retained in the nationalised vehicle that became NRAM. This process increased the overall credit risk of the retained book – which also impacted cost of funding.

NRAM took on liability for repaying the government loan. It was under an obligation to repay the loan as quickly as possible. But this doesn't mean that the commercial imperative to do so meant that NRAM unfairly exploited its customers – that there was "profiteering".

As with any lender, NRAM was required to balance the needs of servicing its funding streams with the interests of its customers. During this period, it reduced its SVR on several occasions. Although it didn't reduce the SVR to the same extent that base rate reduced, I've explained that its costs were not directly linked to, and increasingly separate from, base rate at this time. I've not seen any evidence that the reductions it made to the SVR were arbitrary or unfair, or led to an excessive SVR being charged. While NRAM's SVR was at the higher end of mortgage SVRs across the industry at this time, it was not an outlier. Many lenders charged lower SVRs – but many lenders charged higher SVRs, including mainstream lenders. While rates charged by other lenders did not directly impact NRAM's own cost of funding, that comparison does show that similar pressures were faced across the industry and led – in terms of overall SVR levels – to similar results. And that is a relevant factor for me to consider in thinking about whether NRAM acted fairly.

Mr K's representatives have provided a third party academic report on the wider mortgage industry. I've taken that report into account. But I'm not persuaded by it. The report doesn't focus on Northern Rock and then NRAM's specific circumstances, and doesn't consider possible reasons for increased margins over LIBOR in costs of funding of the sort that I'm satisfied were faced at the time. I think the report is of limited value in considering the specific circumstances of this complaint.

Taking all that into account, I am not persuaded that Northern Rock and then NRAM operated the SVR variation clauses in an unfair way when setting and varying the interest rate applied to Mr K's mortgage. Even if a court were to find that the relevant terms were unfair pursuant to UTCCR, I'm not persuaded that the exercise of those terms by Northern Rock and then NRAM resulted in an unfair SVR payable (subject to the discount) by Mr K from 10 March 2014 until the date of transfer to Whistletree. And so I don't uphold this part of the complaint.

Did Whistletree act fairly and reasonably in setting the interest rate on transfer and thereafter?

I've said that I'm satisfied that the interest rate charged by NRAM between March 2014 and the transfer to Whistletree in 2016 was a fair rate. So now I need to consider whether, following the transfer, it continued to be a fair rate. In addressing this part of the complaint, I

think there are two key questions:

- Should, acting fairly, Whistletree have reduced the SVR to align with the TSB SVR on transfer or thereafter?

- Has Whistletree acted fairly and reasonably in varying the SVR when it did?

I will deal with each of those questions in turn.

The SVR on transfer and alignment with the TSB SVR

Mr K's representative says that on acquiring his mortgage, TSB Bank plc ought to have reduced the SVR so that it was no more than the TSB SVR. This could have been done either by moving Mr K onto the TSB SVR, or by reducing the Whistletree SVR to the same level as the TSB SVR.

I've reminded myself of Mr K's representative's arguments, which are in summary:

- At this time interest rates were not increasing, there was no government loan owed by Whistletree, and the factors relating to the global financial crisis were long in the past.

- Clause 7 of Northern Rock's general mortgage conditions, which the investigator cited, cannot be relevant. Those terms were only ever intended to relate to Northern Rock, and therefore "ceased to have any contractual application or practical relevance" following the transfer of the mortgage.

- As is clear from the TSB SVR, the way TSB Bank plc – including Whistletree – operated was very different from Northern Rock and NRAM. And so even if the SVR was set according to the need for "a prudent level of profitability" or for "good commercial reasons", the Whistletree SVR should have been set at the same level as the TSB SVR.

- The focus should therefore not just be on the SVR variations carried out by Northern Rock and NRAM – but also on Whistletree's failure to vary the SVR. There was no justification for continuing to maintain the SVR at a margin of 4.29% above base rate when the reasons for setting it at that margin no longer applied by virtue of the transfer to Whistletree.

- In those circumstances, in maintaining the SVR at such a high level Whistletree was acting in breach of express and implied terms of the mortgage contract. And this did not result in fair treatment of Mr K.

I've explained above why I don't agree that Northern Rock's General Conditions are no longer relevant. Notwithstanding the transfers to NRAM and then Whistletree, they remain part of the mortgage contract and both parties remain subject to them.

Section 1.2 of the conditions defines the SVR:

> *… 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 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 under condition 7 or the Offer.

Section 19 says

19.1 We may transfer or change or otherwise dispose of the Offer or any of our rights under the offer (including the right to set the Interest Rate) to any person at any time at law or in equity without your consent. Where we transfer to any person the right to set the Interest Rate, that person may set the interest charged under the Offer by reference to that person's own (or one of its own) standard variable rates.

It's therefore clear from both these parts of the terms and conditions that on transfer, Whistletree had the power to set the SVR. Section 1.2 says that a transferee "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". And section 19 says a transferee "may set the interest charged under the Offer by reference to that person's own (or one of its own) standard variable rates".

Using these conditions, Whistletree could have replaced the NRAM SVR with its own SVR – including the TSB SVR (or other TSB reversion rate). However, it's also clear that Whistletree was not obliged to do so. This is a discretionary power – "that person may", not must – and so equally Whistletree could have chosen to retain the SVR at the same level as the NRAM SVR.

Nor is there any obligation in section 7 of the general conditions – the SVR variation clause – to vary or review the SVR at any particular time, whether on transfer or otherwise. This section also empowers but does not require Whistletree to act.

On acquiring Mr K's mortgage, TSB Bank plc could have set the interest rate by reference to one of its own rates (such as the TSB SVR) – but equally, under the terms of the contract at least, it was not required to do so. There is no express term compelling it to review the SVR or harmonise it with the TSB SVR, and I don't think there is any basis for implying such a term.

Mr K's representative also suggests that Whistletree had a "Braganza duty" – a duty to exercise its discretion around setting the SVR in a way that is not arbitrary, capricious, perverse, or irrational. To the extent that such a duty does apply as a matter of law (on which I make no definite finding), it would in my view not add anything to the broader question of whether Whistletree acted fairly, which I'll go on to consider next.

I'm therefore satisfied that by choosing to create an SVR for the Whistletree book (including Mr K's mortgage) rather than transfer Mr K's mortgage to the TSB SVR, and by maintaining that SVR at the level inherited from NRAM, TSB Bank plc was not acting in breach of the mortgage terms and conditions.

But I also need to consider whether it acted fairly and reasonably in all the circumstances. In considering that, I bear in mind that even if TSB Bank plc (trading as Whistletree) acted lawfully in line with the terms and conditions – and relevant law is a matter for me to take into account – I must also take into account wider factors, including the regulator's rules and principles for business. Principle 6 obliges a firm to pay due regard to the interests of its customers and treat them fairly. I've taken that into account too.

Whistletree has explained that it didn't harmonise the SVR with the TSB SVR. It's said that on acquisition it maintained Mr K's mortgage on its existing terms and conditions, including the interest rate, so that his mortgage simply continued as it was before. This is standard practice for a mortgage acquisition, and it's neither unusual nor inherently unfair for a firm to have separate books with separate interest rates.

In thinking about whether this was fair and reasonable in all the circumstances of this particular case, I've noted that while earlier parts of my decision focused on Northern Rock and NRAM's costs of funds, cost of raising and servicing funds lent to customers is only one factor that a lender may choose to take account of in setting an SVR.

Whistletree has explained that TSB Bank plc doesn't fund the TSB and Whistletree books separately. But there are other increased costs associated with the Whistletree book beyond the cost of raising the funds lent. As well as the costs of the third party administrator that manages the Whistletree book, TSB Bank plc is required by the terms of its prudential regulation to hold proportionately more capital in respect of its Whistletree mortgages than its TSB mortgages. That increased capital requirement means the Whistletree mortgages cost more.

Whistletree has also shown that, in general, Whistletree mortgages have a higher credit and default risk than TSB mortgages. The precise figures are commercially confidential and so I have received them in confidence, as permitted by DISP 3.5.9 R (2). But in general, I'm satisfied that the Whistletree mortgage book:

- has a higher average loan to value, and a higher proportion of borrowers with high loan to value and negative equity;
- has a higher proportion of interest only borrowers;
- has a higher proportion of borrowers who are or have been in arrears;
- has a higher rate of repossession.

In my experience, it's standard practice for lenders to include an element of pricing for risk in setting interest rates. In general, the higher the credit risk or default risk of a group of loans or mortgages, the higher the interest rate will be. A higher risk book tends to be more expensive to fund – wholesale funders and others applying a higher premium. And if proportionately more customers are likely to fall into arrears or default, more interest needs to be charged to the remaining customers to generate the same level of income.

Therefore, I think that if TSB Bank plc did separate out the costs of funding the TSB and Whistletree books, it's likely that, as a higher risk book and one requiring proportionately more capital to be held to meet prudential requirements, the Whistletree book's costs would be higher than the TSB book's. And for the same reasons, I'm satisfied that even though the costs of funding are not accounted for separately, it's likely the Whistletree book contributes more to the overall cost of funding TSB Bank plc's mortgage business than the proportion of that business it represents. I'm also satisfied that the Whistletree book presents a higher credit risk and default risk, which is a reasonable factor to take into account in setting an interest rate (and which is one of the factors included in the SVR variation clause). For all those reasons, there are legitimate grounds for TSB Bank plc to have set the Whistletree SVR at a level higher than the TSB SVR.

The Financial Ombudsman Service is not a price regulator. It is not within my remit to set Whistletree's SVR for it, or to decide whether in isolation the SVR represents a fair price. But it is within my remit to decide whether it was fair and reasonable for Whistletree to charge

Mr K an interest rate dependent on setting its SVR at the level inherited from NRAM rather than an interest rate based on either the TSB SVR directly or the harmonisation of the Whistletree SVR with the TSB SVR.

Having considered all the evidence, I'm satisfied that while Whistletree had the contractual power to revise the SVR and / or set it afresh at the time of the transfer, there was no obligation for it to do so. Equally, it had the power to maintain it at the same level as that charged by NRAM.

I've already noted that the NRAM SVR around this time was towards the upper end of – but not an outlier to – the range of SVRs charged by mainstream lenders around this time, and it follows that was the case for the Whistletree SVR post-transfer as well.

Whistletree was required to pay due regard to the interests of its customers and treat them fairly. This does not mean that its customers' interests are the only relevant factor, but they must weigh in the balance and customers – including Mr K – must be treated fairly.

While Whistletree did not reduce the SVR on transfer, I've found there were good reasons why a higher SVR than the TSB SVR was justified. These included distinct factors associated with the Whistletree book, and I've not seen any evidence that the Whistletree SVR was set illegitimately or to "profiteer".

I note that the Whistletree SVR was set at the same level as the NRAM SVR, and therefore Whistletree did not increase the amount Mr K paid as a result of the transfer – instead continuing the mortgage on the same terms with the same payments, terms which were not disproportionate compared to other SVRs in the mortgage industry at that time, and which meant that the transfer had no detrimental impact on Mr K.

In all the circumstances, I'm satisfied that in setting its SVR at the level it did post-transfer, Whistletree did not treat Mr K unfairly or unreasonably.

Variations of the Whistletree SVR following the transfer

Since the acquisition of Mr K's mortgage by Whistletree in 2016, the only variations to the SVR have been at the same time, and by the same amount, as changes to Bank of England base rate.

Whistletree continued to rely on section 7 of Northern Rock's General Conditions to vary the SVR. My previous findings on the fairness of that term and the fairness of relying on it therefore also apply to this section of the complaint.

TSB Bank plc's mortgage funding – including the Whistletree book – is largely funded by reference to LIBOR (later replaced by SONIA). Although LIBOR (and SONIA) are not the same as base rate, to a large extent the dislocation between LIBOR and base rate seen during the global financial crisis no longer applies. In broad terms, changes to LIBOR (and SONIA) reflect changes in base rate. It's fair and reasonable for Whistletree to vary the SVR to reflect changes in its underlying cost of funding. And I'm satisfied that it was fair and reasonable for Whistletree to vary the SVR in the way, and at the times and for the amounts, that it did.

Conclusion

For all the reasons I've set out above, my conclusions on this complaint are that:

- Notwithstanding the later transfers of the mortgage, the mortgage remains governed

(as it has been throughout) by the terms of the offer given to Mr K and by Northern Rock's General Conditions Edition 3.

- It was not unfair for NRAM to charge Mr K, from 10 March 2014, an interest rate calculated by discounting 0.01% from the NRAM SVR as it was at that time and taking into account the history which led up to that point.

- It was not unfair for Whistletree to charge Mr K an interest rate calculated by discounting 0.01% from the Whistletree SVR, based in turn on the NRAM SVR as it was at the date of the transfer.

- It was not unfair for Whistletree to charge Mr K an interest rate calculated by discounting 0.01% from the Whistletree SVR, varied from time to time as it was between 2016 and 2020.

My final decision

For the reasons I've given, my final decision is that I don't uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr K to accept or reject my decision before 7 July 2023.

Simon Pugh
Ombudsman