DRN-4321677

The complaint

Mr and Mrs L complain that Kensington Mortgage Company Limited wouldn't allow them to take a new fixed interest rate on their mortgage.

What happened

Mr and Mrs L had a mortgage with Kensington – during the course of this complaint, it's been transferred to a new lender, but as the complaint relates to the period of Kensington's ownership, and because the complaint was made before the transfer, Kensington remains responsible for answering this complaint.

Mr and Mrs L took their mortgage out in 2006, borrowing around £175,000 on interest only terms over 23 years. Their mortgage was on a fixed rate of 7.79% for the first three years, followed by a variable rate 3% above Kensington's standard variable rate (SVR). The SVR was linked to the LIBOR rate, such that it would never be less than 1% above LIBOR or more than 3% above LIBOR.

In practice the SVR has tended to be set at 3% above LIBOR, which means that following the end of their fixed rate Mr and Mrs L were paying 6% above LIBOR. LIBOR was withdrawn in 2021 and after that the SVR was linked to Kensington's LIBOR replacement.

Mr and Mrs L say they've asked Kensington about taking new interest rates over the years, but it's told them it didn't have any rates available to them. However, in June 2022, Kensington did write to offer Mr and Mrs L a reduced variable rate (a rate it calls its "mortgage prisoner rate"). Mr and Mrs L accepted that rate, and complained that Kensington hadn't previously offered them a lower interest rate.

Kensington said this was an offer "unlikely to be repeated". The rate it offered was linked to the Kensington Standard Rate (KSR) – tracking 3.88% above the KSR for the rest of the mortgage term. The offer said the KSR would be reviewed quarterly and set at 1% above the Bank of England base rate at the time of the review. Kensington said it was making this offer because it had identified that Mr and Mrs L were potential mortgage prisoners – meaning they were up to date with their mortgage but unable to take an alternative product.

In effect, therefore, in June 2022 Mr and Mrs L moved from a rate 6% above the LIBOR replacement to one 4.88% above Bank of England base rate.

Mr and Mrs L have previously complained about the circumstances in which they took out this mortgage, and whether Kensington has treated them fairly in the options made available to them to deal with repayment of the capital by the end of the term. We said that the complaint about the lending decision was out of time, and that Kensington hadn't acted unfairly – it was currently unaffordable for Mr and Mrs L to switch to repayment terms, but they and Kensington should keep matters under review. As we've dealt with those complaints before, I won't say anything further about them here.

This complaint is about whether it was fair that Kensington didn't offer Mr and Mrs L a new interest rate before 2022.

Kensington said it hadn't acted unfairly. It told Mr and Mrs L that their mortgage had been securitised, which meant their interest rate could not be reviewed before 31 March 2022, so Kensington could not have offered Mr and Mrs L a new rate before it did.

Our investigator thought the complaint should be upheld. She said Mr and Mrs L had asked for a new rate in July 2019 and acting fairly Kensington ought to have offered them a new rate at that point. She said Kensington should ensure their mortgage was re-worked as if that had happened, and it should pay them £300 compensation.

Mr and Mrs L broadly accepted that outcome, but said that the rate should be backdated further, to 2017. Kensington didn't agree. It said Mr and Mrs L weren't eligible for a new interest rate until 2022 and the rate it had offered them in June 2022 was fair. It didn't think it should take any further action. As no agreement could be reached, the complaint comes to me for a decision to be made.

What I've decided – and why

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

Mr and Mrs L's mortgage was taken out in 2006, before the global financial crisis. Kensington has explained to us that its lending business model is very different now. It says that Mr and Mrs L's mortgage – along with others taken out around the same time – has been securitised. It's a term of the securitisation that no changes can be made, and so it wasn't able to offer them a new interest rate before June 2022.

Securitisation isn't unusual in the mortgage industry, and not inherently unfair. But it's a choice made by Kensington to structure its business in a particular way, and as such it's something done to Mr and Mrs L's mortgage by Kensington, rather than being of itself a characteristic of them or their mortgage.

That's important because of the relevance of a particular provision in the mortgage rules to this complaint. The mortgage rules are known as MCOB, and MCOB 11.8.1 E (the E means this is an evidential provision rather than a rule) says that where a borrower is unable to move their mortgage elsewhere, their existing mortgage lender

> "should not (for example, by offering less favourable interest rates or other terms) take advantage of the customer's situation or treat the customer any less favourably than it would treat other customers with similar characteristics. To do so may be relied on as tending to show" a breach of the requirement to treat customers fairly.

Kensington didn't offer new interest rates to any existing customers before 2017. And so when it didn't offer a new rate to Mr and Mrs L, it wasn't acting unfairly – there's no requirement to offer new rates to existing customers, and other customers weren't being treated more favourably than Mr and Mrs L.

Once Kensington did start offering rates, however, it should have done so fairly. It's entitled to have eligibility criteria – which might mean some customers are eligible for rates and others aren't – but any application should be considered fairly.

Kensington's criteria for offering rates include matters such as loan to value, and that the mortgage should not be in arrears or have other sums outstanding. Mr and Mrs L met those criteria.

Its criteria also include that rates are not available to customers whose mortgage was taken out before 2010 – and that includes Mr and Mrs L. I'm not persuaded that this resulted in fair treatment of Mr and Mrs L. I'm satisfied that Mr and Mrs L were unable to move their mortgage elsewhere to look for a better rate. I say that because of everything they've said about their circumstances; because they've got an interest only mortgage and switching to repayment terms is unlikely to be unaffordable for them; and – not least – because Kensington itself concluded they were "mortgage prisoners" in 2022.

So Mr and Mrs L were unable to take a new interest rate by moving to another lender. Regardless of what Kensington charged them, they were obliged to remain with Kensington. I'm satisfied that means MCOB 11.8.1 E is relevant here. It doesn't always mean that there is unfairness where a customer is refused a new interest rate. But I think it's aimed at ensuring that where a customer can't shop around – as Mr and Mrs L can't – they're treated fairly by their existing lender and not offered worse rates than other customers who could shop around.

Mr and Mrs L met most of Kensington's rate switch criteria. They had an acceptable loan to value and – by 2019 – their mortgage hadn't been in arrears for some time and was up to date.

They didn't meet the requirement to have taken out their mortgage after 2010. But I'm not satisfied it was fair for Kensington to use this – or the terms on which their mortgage was securitised as a result – to refuse them a rate. I don't think the age of their mortgage is a relevant characteristic for the purposes of the comparison envisaged in MCOB 11.8.1 E. Nor is the fact that it's been securitised – that's not a characteristic of Mr and Mrs L or their mortgage; it's a choice made by Kensington to organise its business in a certain way. I don't think it's fair to say that Kensington's obligations of fair treatment don't apply because of how it's chosen to structure its business.

I'm therefore satisfied that a customer whose mortgage was taken out after 2010, but who was otherwise similar to Mr and Mrs L, would have been offered a new rate. That other customer has similar characteristics to Mr and Mrs L, but Mr and Mrs L were treated less favourably. I don't think that's fair.

Our investigator reached the same conclusion. In reply, Kensington said there was another reason Mr and Mrs L didn't qualify for a new rate. It said that was because the reversion rate on any fixed rate they might take was higher than the reversion rate they were currently on – and it was part of its standard criteria that it didn't offer rates in this situation. I'm not persuaded by this.

It's arguable that this ought fairly to be a matter for a customer to decide. A customer might not go on to the reversion rate after a new fixed rate if Kensington ought fairly to offer another new rate at that point.

In any case I don't need to decide this point, since it doesn't apply to Mr and Mrs L. Kensington said the reversion rate on the fixed rate that would have been available to them in 2019 was 4% above LIBOR, whereas Mr and Mrs L's existing rate was at the time 3% above LIBOR. As the reversion rate on a new fixed rate was higher than their existing reversion rate, they weren't eligible for a rate.

But Kensington isn't right about that. It's SVR was 3% above LIBOR – but Mr and Mrs L weren't on the SVR. Their mortgage offer said their reversion rate was the SVR plus 3%, which means Mr and Mrs L's individual reversion rate was not 3% above LIBOR but 6% above LIBOR. So the reversion rate on the fixed rates available in 2019 – 4% above LIBOR – was lower, not higher, than their existing reversion rate. And so even if this was a fair thing to include in the eligibility criteria, it wasn't a barrier to Mr and Mrs L taking a new rate.

Applying its rate switch criteria correctly, therefore, there was no barrier to Mr and Mrs L taking a new fixed rate with Kensington other than the fact that their mortgage was taken out before 2010 – and I've already explained why, taking into account MCOB 11.8.1 E, I don't think that's a relevant characteristic that should have been used to refuse them a new rate.

I'm therefore satisfied that Kensington ought to have offered Mr and Mrs L a new fixed rate when they enquired about one.

I've thought about when that might be. I've looked at Kensington's records, which show that Mr and Mrs L asked Kensington for a new interest rate in a call on 4 July 2019, but it told them there was nothing available and recommended they take independent financial advice.

Mr and Mrs L say that they asked for a rate before that, they think in 2017. They haven't been able to provide any evidence of that other than their recollection. But in any case, even if they're right about that, I don't think it would be fair to ask Kensington to backdate a new fixed rate to 2017.

I've said that one of Kensington's criteria for a new fixed rate, which it applies to all customers, is that the mortgage must not have been in arrears in the last 12 months. But in 2017 Mr and Mrs L were in arrears having experienced previous financial difficulty. They cleared the arrears in December 2017. The mortgage has been up to date since then. So if Mr and Mrs L did ask Kensington about a new rate in 2017, they wouldn't have been eligible because of the arrears, and it wouldn't be fair to ask Kensington to implement a rate from 2017 now. But by July 2019, they had been free of arrears for over 18 months, and so did meet Kensington's criteria.

Putting things right

To put matters right, Kensington should put Mr and Mrs L back in the position they would have been in had it treated them fairly when they asked for a rate in July 2019.

At that time, for Mr and Mrs L's then loan to value, it had a five year fixed rate of 4.09% available. Mr and Mrs L say they would have taken a five year rate to give them long term stability and I see no reason to doubt what they say. Assuming some time to process an application, I think Kensington should re-work their mortgage as if that rate had been implemented from 1 September 2019.

While this complaint has been in progress, Kensington has transferred Mr and Mrs L's mortgage to a new lender. That makes the redress less straightforward.

Mr and Mrs L have paid more than they should have done since 1 September 2019, because they've been charged more interest than they would have been on a fixed rate of 4.09%.

Firstly, Kensington should ask Mr and Mrs L whether they want those additional payments refunded to them, or used to reduce their mortgage balance.

If Mr and Mrs L want a refund, Kensington should calculate the amount Mr and Mrs L have overpaid between September 2019 and the date it makes the calculation. It should add simple annual interest of 8% running from the date of each monthly overpayment to the date of the refund. And it should pay the result to Mr and Mrs L as a lump sum. If Mr and Mrs L choose this option, Kensington can deduct income tax from the 8% interest element of my award, as required by HMRC, but it should tell Mr and Mrs L what it's deducted so they can reclaim the tax if they're eligible to do so.

If, on the other hand, Mr and Mrs L want the overpayments used to reduce their mortgage balance, Kensington should work through their mortgage month by month, reducing the balance by the overpayment each month and reducing the interest charged in subsequent months to account for the lower balance. Doing this should give Kensington the balance of their mortgage as at the date of the calculation as it would have been based on what Mr and Mrs L actually paid and the revised interest rate. It should then find out their actual balance from the new lender and pay the difference between the two to the new lender to reduce their balance to what it should be.

Kensington hasn't told us whether the 4.09% rate included an arrangement fee, but if it did Kensington can offset the fee from whichever redress option Mr and Mrs L choose.

For the remaining payments between the calculation and the expiry of the fixed rate at the end of August 2024, Kensington will need to make arrangements with the new lender to ensure that Mr and Mrs L are charged a fixed rate of 4.09%.

From August 2024 onwards, if Mr and Mrs L had taken the fixed rate in 2019 their interest rate would revert to 4% above LIBOR – now the Kensington Synthetic LIBOR Rate (KSLR) Kensington uses to replace LIBOR. And so Kensington will also need to make arrangements with the new lender to ensure that Mr and Mrs L are charged 4% above KSLR, rather than 3.88% above KSR, from August 2024 onwards – unless the new lender is able to offer them a new fixed rate at that time. That's because if Mr and Mrs L had taken a fixed rate in 2019 they wouldn't have taken the "mortgage prisoner" rate in 2022, so after the expiry of the fixed rate they should be charged that lender's fixed rate not the "mortgage prisoner" rate.

In either case, if Kensington is unable to ensure the new lender adjusts the interest rate in the way I've set out above, Kensington will need to keep matters under review and compensate Mr and Mrs L on an ongoing basis for each month in which they are charged more interest than they should have been until their mortgage is paid off or until the new lender offers them a new interest rate (if it has them available), whichever comes first.

Finally, I agree that Mr and Mrs L were caused distress and inconvenience through having to pay more interest than they should have done, because Kensington unfairly refused them an interest rate in 2019. I agree £300 is fair compensation.

My final decision

My final decision is that I uphold this complaint. Kensington Mortgage Company Limited should put matters right in the way I've set out above.

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

Simon Pugh
Ombudsman