

## The complaint

Mr J and Ms D complain about how Coventry Building Society is managing their offset mortgage. They said that although their mortgage is fully offset, Coventry continues to take occasional payments, without warning, and had recently taken a large sum.

## What happened

Mr J and Ms D told us they took out an interest only offset mortgage with Coventry in December 2020. By early 2021 they had paid enough into the linked savings account for their mortgage balance to be more than fully offset. So they weren't expecting to have to make any monthly mortgage payments. But they said during 2022, several small direct debits were taken, and in January 2023 a much larger sum was taken, of £612.36.

Mr J and Ms D didn't think it was right for a mortgage which was supposed to be fully offset, to still charge interest. They said this directly contradicted Coventry's literature, which says *".... We only charge you interest on the difference between your mortgage and your savings balance...."* They also said that sometimes Coventry wasn't crediting them with interest until two months later, which must also be costing them extra interest.

Mr J and Ms D wanted Coventry to refund all the interest it had charged them while the mortgage was fully offset, and any additional interest it had only charged because they weren't credited with savings interest until two months later.

Coventry said it hadn't sold this mortgage to Mr J and Ms D. They had taken this mortgage out on the advice of a broker. So Coventry said it would have expected that broker to explain to Mr J and Ms D how this mortgage worked.

And Coventry said this mortgage was working the way it would expect. It explained to Mr J and Ms D that an offset mortgage has two parts - the mortgage account, and a linked savings account. Each month, the savings account earns interest, and at the start of the following month, the interest (which Coventry calls *"benefit"*) earned on those savings is used, first, to pay off the monthly payments due on the mortgage account.

Although interest is usually earned on the savings account at the same rate as it's charged on the mortgage account, because the interest is earned and charged on different months, the amounts aren't always the same. So a mortgage payment is needed in months when the interest rate rises, or when the previous month (when interest was earned) had fewer days than the month interest is being charged on.

Conversely, when the previous month has more days than the month interest is being charged on, there can be a little of the interest (or benefit) left over. When that happens, Coventry uses that to reduce the balance owed on their mortgage.

Coventry said that Mr J and Ms D had previously been paying their mortgage payment early in the month, and that meant Coventry didn't have enough time to base their direct debit on the previous month's earned interest. In that situation, it had to base the direct debit on the interest earned the month before. Coventry said it had now amended the direct debit date for

Mr J and Ms D, so this wouldn't be a problem in future.

And Coventry said that the large payment taken in January 2023 happened when Mr J and Ms D's fixed interest rate ended on 31 December 2022. So they started to pay Coventry's Standard Variable Rate. This meant their interest rate rose quite sharply, from 1.87% to 5.34%. The offset interest earned on the savings was based on their previous rate of 1.87%, but the interest charged on their borrowing was based on the new rate of 5.34%. So that's why Coventry claimed a direct debit payment of £612.36 on 4 January 2023.

Coventry said if interest rates go down in future, then the opposite would happen. As when a shorter month follows a longer one, no direct debit would be charged, and Coventry would use the excess amount of interest earned to reduce the balance of their mortgage.

Coventry didn't think it had done anything wrong. It had written to Mr J and Ms D twice, the first time to explain how their offset mortgage worked, and the second time, it had responded to their complaint, explaining again, but this time also saying it had changed the date of their direct debit to later in the month.

Our investigator didn't think this complaint should be upheld. He said he'd read the guide to how the offsetting mortgage worked, and he also thought this mortgage was operating in line with that guide. He set out in some detail for Mr J and Ms D how their offset mortgage would work. And he said it was their broker's responsibility to explain to Mr J and Ms D how the mortgage worked before they took out this mortgage, not Coventry's.

Our investigator explained that interest accrued on the savings held to offset the mortgage was paid one month in arrears. That explained why Mr J and Ms D had been charged in January, when their interest rate went up. Our investigator also said he could see Coventry had explained why it used to use the interest from two months previously to cover the monthly payments, as well as why it changed Mr J and Ms D's payment date so this didn't happen in future.

Our investigator said, unfortunately, as Mr J and Ms D had found, it wasn't always possible to completely offset and avoid making any payments at all towards a mortgage, due to the differing number of days in a month and the impact of changes in interest rates. But he didn't think Coventry was doing anything wrong.

Mr J replied to disagree. He said Coventry had repeatedly used the phrase "*.... we only charge interest on the difference between your offset savings balance and the mortgage amount*" in its guide to the offset mortgage but also on other communications like his annual mortgage statement. That gave the misleading impression that interest will not be charged while a mortgage is fully offset.

Mr J felt that the underlying way in which this mortgage operated was unfair, because he was being charged interest on a mortgage account which was more than fully offset. And he said it wasn't a justification just to say other lenders did the same.

Mr J didn't think our investigator had looked at the impact of crediting interest only from two months previously, not one month. He said that only seemed to operate in Coventry's favour, and if Coventry could have fixed this, it should have done so a year ago, when he first contacted it about this mortgage.

Mr J said he wasn't told about the direct debit payment of £612.36 before it was taken in January 2023. He could have fixed a new rate, or even paid the mortgage off entirely, if he'd known this payment was going to be taken. Mr J said that direct debits had been taken again in February and March 2023, and he couldn't see how these had been worked out.

Mr J also said he'd had no notice of changes in interest rates, although he's since asked to withdraw this point.

Our investigator wrote again, to say that the guide to offset mortgages needed to be read in full to understand how a mortgage like this one works. He said that just relying on one sentence wouldn't give a true reflection of how the account operates.

Our investigator said Mr J would be able to see that, in fact, his mortgage balance was going down slightly over time, although it was a repayment mortgage. That reduction in his balance was greater, on his 2022 statement, than the direct debit payments he'd made that year.

Our investigator said what Mr J was complaining about was, in essence, how an offset mortgage works. Applying interest two months after it was earned wouldn't always work in Coventry's favour – if interest rates decrease, then the benefit wouldn't have reduced for two months. But this wasn't an issue now Mr J and Ms D had changed their payment date.

Our investigator said Coventry had told Mr J and Ms D about the changes in their interest rate which resulted in the January direct debit being claimed. And he said Coventry hadn't profited, as that payment had reduced the capital balance on the mortgage. Mr J and Ms D had then been asked for small payments in each of the following two months, because their mortgage interest rate had increased slightly during those months.

Our investigator reiterated that he didn't think Coventry had done anything wrong.

Mr J still disagreed. Aside from the point he'd asked to withdraw, he said he was dissatisfied with our service's response. In particular he was unconvinced by our investigator's suggestion that Coventry was effectively using his interest payments to reduce his capital debt. He said it seemed illogical, and he couldn't see that explained in the literature. And he said he had no practical way of checking, as he only gets annual statements.

Mr J said he wanted this complaint to be reviewed by an ombudsman, so it came to me for a final decision. And I then reached my provisional decision on this case.

### **My provisional decision**

I issued a provisional decision on this complaint and explained why I did propose to uphold it in part. This is what I said then:

I will arrange for Mr J and Ms D to be sent the short table that Coventry has sent our service, showing how their payments have been applied in early 2023. Although their balance does fluctuate, as one would expect, I don't think there's any suggestion that their mortgage balance is being increased, as they have claimed.

As Coventry's guide explains, Mr J and Ms D have two accounts. They have a mortgage account, with a debt on which interest is charged. And they have a savings account, which earns interest at the same rate which is charged on their mortgage that month.

Mr J says he shouldn't be paying any interest, because he doesn't owe Coventry any money. But he does – he and Ms D together owe it over £200,000.

Mr J and Ms D also happen to have the same amount in a separate account, as savings. But the existence of a large savings lump sum doesn't change the fact that Mr J and Ms D still have a debt to Coventry. The debt and savings are still separate

amounts. And Mr J and Ms D are under no obligation to keep their savings in the linked account.

Placing their savings in an offset account means Mr J and Ms D often don't have to make mortgage payments. And when they do, those payments aren't anywhere near as large as they would otherwise be.

But this debt and savings are still separate amounts. So if Mr J and Ms D want to move their savings elsewhere, or simply spend them, they have the option to do so. That is considerably more flexible than applying for fresh mortgage lending.

Usually, Mr J and Ms D won't need to pay much towards their mortgage, if anything. But sometimes they will need to make a payment. So, even if Mr J and Ms D's mortgage is fully offset, they still need to have a direct debit in place.

That's because of how this arrangement works. What Coventry is doing, is to take the savings interest that Mr J and Ms D earned during the previous month, and use it towards the payment of mortgage interest that they are about to be charged for the following month.

I know that Mr J and Ms D take the view that much of the publicity Coventry has produced is misleading. I'll return to this point below. But before I look at that, I wanted to confirm that I do think their account overall is working in the way that Coventry intended, and in the way it has explained in the guide to their mortgage which I've seen.

I don't know if Mr J and Ms D had understood how this mortgage works, before they took out the lending. But, as Coventry has pointed out, it didn't provide Mr J and Ms D with any mortgage advice. They took out this mortgage with the support of a broker, and I would have expected that broker to advise them on this, if they weren't clear on how it might work.

Mr J and Ms D said they didn't know when Coventry was going to ask them to make a payment. And if they had known, before the January direct debit, they could have re-fixed the interest rate on their mortgage, or might even have paid it off.

The direct debit guarantee says this –

*If there are any changes to the amount, date or frequency of your Direct Debit the organisation will notify you (normally 10 working days) in advance of your account being debited or as otherwise agreed.*

That usually means banks tell customers before their monthly payment changes. However, the guarantee itself says that customers and banks can agree something different, between them. And in this case, Coventry has been able to show that its original mortgage offer to Mr J and Ms D contained the following, in reference to the option to reduce monthly mortgage payments –

*If you take advantage of [the option to make your monthly payment less than it would have been] you agree that under the Direct Debit Scheme we need not give you Advance Notice of the amount of each reduced payment.*

So I do think Mr J and Ms D have agreed to waive the usual notice of a change in upcoming direct debit payments. Coventry has told us it does inform Mr J and Ms D of any change in the underlying interest charged on their mortgage account each month. But it doesn't tell them each month how much of that will be paid by the interest from

their offset savings. I do think that's in line with what Mr J and Ms D were offered originally, and agreed to.

There is one thing I wanted to clarify from our investigator's view. He suggested that the interest payments Mr J and Ms D were making, were being used to reduce their balance. And I don't think that's right. I think those payments are being used to pay interest charged on the mortgage debt which the previous month's savings interest (or benefit) isn't enough to cover. But, as I've explained above, in months with fewer days than the preceding month, or months after an interest rate reduction, there is likely to be a surplus. And when there is a surplus, Coventry is deducting that from Mr J and Ms D's overall debt.

I want to turn, finally, to where I think this complaint may have started, with the wording Coventry uses in its annual statements, and elsewhere, to describe this mortgage. Mr J has repeatedly quoted Coventry as saying "*We only charge you interest on the difference between your mortgage and your savings balance.*" And I can see that Coventry does say that, in a number of places. It also makes similar statements, like this one "*We will charge interest as if the balance of advances (including any further advances) owed on your mortgage was reduced by the amount in your Offset Savings Account at the time.*"

I do think that's unhelpful when taken in isolation, as this describes a very simple and clear mortgage arrangement, which, in my view, doesn't fit well with what Coventry is actually doing with Mr J and Ms D's mortgage.

Sometimes, as in the offset mortgage guide, this phrase is accompanied by a fuller explanation of how this mortgage actually works. In other places, Coventry signposts customers to that guide, or to the full terms of the mortgage. But in other places, like the annual statement, Coventry simply states the above.

And I think that's what has caused the confusion in this case. Because the above quite short and simple explanation would, I think reasonably, lead Mr J and Ms D to think that they oughtn't to be paying any interest at all on their mortgage when it's fully offset. And as I've explained, I don't think that's how this mortgage was ever intended to work.

I think this has caused Mr J and Ms D a great deal of concern. It's left them thinking that Coventry was making very serious mistakes in the operation of their mortgage. Although I can see that Coventry did respond to Mr J and Ms D's complaint, and explain how their mortgage worked, that didn't deal with Mr J's concerns, which do seem to me to centre on how different Coventry's fuller explanation is, to the short phrase I've quoted above. So Mr J and Ms D have been put to quite some trouble, in making this complaint, to get the reassurance that Coventry isn't wrongly administering their accounts. Because of that, I do think Coventry should pay some compensation in this case.

I have discussed this concern with Coventry, and whilst it doesn't agree that it has steered Mr J and Ms D in the wrong direction, it said it did recognise their loyalty to the Society, so it has now offered to pay Mr J and Ms D £500 to address their disappointment in how their mortgage is working.

My provisional decision is that this would provide a fair and reasonable outcome to this complaint. And because this award was suggested by Coventry, I'd like to reassure Mr J and Ms D that this amount is not less than I would otherwise have awarded in this case, if Coventry hadn't made this offer.

I invited the parties to make any final points, if they wanted, before issuing my final decision. Both sides replied.

### **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.

Coventry wrote to confirm it had received my provisional decision. It said it had nothing further to add. Mr J and Ms D also replied, to say they had no further submissions. They wanted to accept the proposed award, which they thought would provide a reasonable outcome to their complaint. And they closed by thanking our service for its work on their complaint.

So neither side has offered any further evidence or argument, and I haven't changed my mind. I'll now make the decision I originally proposed.

### **My final decision**

My final decision is that Coventry Building Society must pay Mr J and Ms D £500 in compensation.

Under the rules of the Financial Ombudsman Service, I'm required to ask Ms D and Mr J to accept or reject my decision before 22 December 2023.

Esther Absalom-Gough  
**Ombudsman**