

The complaint

Mr B and Mrs H complain about the early repayment charge (ERC) charged by Clydesdale Bank Plc trading as Virgin Money when they repaid their mortgage. They don't think the ERC was fairly charged or fair in amount, and say that Virgin Money didn't properly take Mrs H's vulnerability into account.

What happened

Mr B and Mrs H had a mortgage with Virgin Money. In July 2018 they took a fixed rate running to 30 September 2023. The mortgage offer said that an ERC of 4% of the balance would be charged if the mortgage was repaid before the end of the fixed rate period.

Mr B and Mrs H decided to sell their property and move house. They already owned the property they were moving to. They said they were moving because they were concerned about the cost of living and rising interest rates, and because Mrs H had been unwell with cancer. They applied to port their mortgage to this property, but Virgin Money rejected their application. So they repaid the mortgage in April 2023, including a 4% ERC. The ERC was around £32,500.

Mr B and Mrs H complained. They didn't think the ERC was fair, or that it was fair to charge it. The move was driven by their circumstances, and its timing by the buyer of their property. They said that the charge more than outweighed the lost interest to Virgin Money by repaying their mortgage six months early. They said they would be willing to pay the remaining interest instead of the ERC. And they said that Mrs H was vulnerable, and Virgin Money hadn't given proper thought to her circumstances in deciding whether to charge the ERC.

Virgin Money said it had been willing to consider porting the mortgage to Mr B and Mrs H's other property. But following a valuation that property wasn't suitable security for the mortgage, so it couldn't agree to port. In those circumstances the ERC was properly chargeable. It offered £50 compensation for delays in sending documentation to Mr B and Mrs H when they first asked about porting their mortgage.

Our investigator thought that was a fair offer. She didn't think it was unfair that Virgin Money had charged and not refunded the ERC. So Mr B and Mrs H asked for their complaint to be reviewed by an ombudsman.

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'm sorry to hear about Mrs H's illness, and I wish her a speedy recovery. I can understand why, in the circumstances, Mr B and Mrs H chose to relocate when they did.

I've thought about whether Virgin Money treated them unfairly. I don't think it did, for reasons I'll explain.

Mr B and Mrs H have referred to the regulator's consumer duty rules. But that set of rules didn't come into force until 31 July 2023 which was after the events of this complaint. And even when it did come into force, it didn't apply to ERCs on mortgages agreed before that date (referred to in the rules as "vested rights") – it's not a relevant consideration for this case.

When Mr B and Mrs H took their fixed rate in 2018, the mortgage offer explained that an ERC would apply if it was repaid before 1 October 2023. It said the ERC would be 4% of the balance at the time. So the offer was clear that there would be an ERC, and how much it would be.

The offer also said that Mr B and Mrs H could transfer their mortgage product – the fixed interest rate – to a new mortgage if they moved house. But it said that depended on whether it would be willing to accept a new mortgage application.

The offer also said that "you must be selling this property and purchasing another property as your home and complete the new loan within three months of repaying this loan". If the new mortgage completed at the same time as the old one was repaid, there would be no ERC. If a new mortgage didn't complete at the same time, the ERC would be payable, but would be refunded provided the new mortgage completed within the three month time limit.

In this case, Mr B and Mrs H weren't purchasing a new property. They were moving to a property they already owned. But even though this was, strictly, outside the terms of what was allowed by the mortgage offer Virgin Money was willing to consider an application to port their mortgage interest to a new mortgage.

There was some delay in starting the mortgage process, for which Virgin Money has offered £50 compensation. It then asked Mr B and Mrs H to pay around £500 for a valuation of the property they wanted to port their mortgage to.

The valuation took place in May 2023. The valuer attended the property. He noted that it was a semi-detached property. Mr B and Mrs H also owned the adjoining property, in which their daughter lived. This property was separately registered under a different title at the Land Registry. But Mr B and Mrs H had installed connecting doors between the two properties, which meant they weren't self-contained.

This meant that the property didn't meet Virgin Money's lending criteria. It won't lend secured on property that isn't self-contained and separate from neighbouring property. That's because if it ever has to repossess and sell the property it would be much harder to do so – or would require works to separate them first.

Virgin Money explained this to Mr B and Mrs H. It said it couldn't lend on this property. But it said it would be willing to reconsider if Mr B and Mrs H agreed to separate the properties and undertake not to join them back together again, or if they merged the titles so that Virgin Money could have security over both under one title. Mr B and Mrs H didn't agree to either of those options. So Virgin Money rejected their application for a new mortgage.

I think this was fair. The fact that there were two properties, only one of which would be mortgaged to Virgin Money but which weren't separate and self-contained, meant that Virgin Money wasn't willing to lend. This was a reasonable decision for it to make. It was also fair that Virgin Money didn't agree to refund the valuation fee. It's a non-refundable fee, and the valuation did take place. There's never any guarantee that a mortgage will go ahead, but that doesn't mean it's unfair for a lender to recover the costs of the application.

The result was that Mr B and Mrs H had no new mortgage to port their interest rate to.

They'd paid the ERC when they sold their other property. Without a new mortgage, the ERC wouldn't be refunded.

Again, this wasn't unfair. This is what the mortgage offer Mr B and Mrs H agreed to said would happen if they repaid early without taking a new mortgage. I appreciate why Mr B and Mrs H's circumstances meant they felt they needed to sell their other property – but that doesn't stop the ERC from being chargeable.

At this time, Virgin Money wasn't aware of Mrs H's illness. It only became aware when they complained. So it's not something that it could have taken into account. But even if it knew, I don't think it would – or should – have made a difference. The ERC would still be properly chargeable, and the property Mr B and Mrs H moved to would still be unsuitable for a new mortgage. In circumstances where the ERC caused serious financial difficulty or even prevented a move necessary for health reasons it might be fair to take that into account in thinking about whether charging the ERC was fair. But that's not the case here.

I'm therefore satisfied that, in principle, it was fair and reasonable for Virgin Money to charge Mr B and Mrs H an ERC when they ended their fixed rate early.

I've also thought about whether the amount of the ERC was fair. The amount was clearly set out in the mortgage offer – which is an important consideration.

Mr B and Mrs H have pointed out that the ERC of around £32,000 is much more than the extra interest they would have paid had they kept the mortgage for the six months left of the fixed rate. And that's true. But I don't think that means that the ERC was unfair.

The rules of mortgage regulation require an ERC to be a reasonable pre-estimate of the loss to a lender of a mortgage being repaid early. The rules also say that the estimate can be made across a group of mortgages – not on an individual basis.

The reason for that is that the ERC must be set out in the mortgage offer – both in terms of how it's calculated, and how much it could be in cash terms. But a mortgage offer is issued at the start of a mortgage. At that point it can't be known if – or when – a borrower might choose to end their mortgage early. It's not therefore possible to pre-estimate the loss on an individual basis at that point.

However, across a group of mortgages – such as all the ones it lends at the same rate – a lender will know how many customers on average will choose to repay early, and the average time left when they do so. It can therefore estimate the loss across the group of mortgages as a whole, and apportion it to individual mortgages within the group.

That means that where any individual borrower ends their mortgage early, the loss on that individual mortgage may be more or less than the ERC charged. If it's more, the lender can't charge the borrower the difference, but if it's less the lender isn't required to reduce that individual ERC. What matters is the average cost across the group of mortgages, not the cost on an individual basis.

It's also important to bear in mind that the loss to Virgin Money is not just the interest it will no longer receive if a mortgage it repaid early. It's also the cost of, in turn, having to unwind its own arrangements for raising the funds it lent on earlier than expected. It can't always simply re-lend those funds to another customer if doing so would tie the funds up for longer than the time Virgin Money agreed to repay its own funders.

Virgin Money has shared with us how it calculated the ERC across this group of mortgages, arriving at the pre-estimate that led it to charge 4%. That information is commercially

confidential. Our rules allow us to receive information in confidence where appropriate, which I think it is in this case. But in summary the information shows that Virgin Money estimated how many borrowers would end their mortgage early and when, how much that would cost, and how that led to the calculation that 4% was a reasonable ERC.

So while I understand Mr B and Mrs H think it was unfair that Virgin Money charged them an ERC larger than the interest they would have paid, I'm afraid I don't agree. An ERC isn't a penalty for breach of contract. It's the price paid for exercising the contractual right to end the mortgage early. The price is set not by reference to the individual cost of early exit for that mortgage on that day, but on a group basis estimated at the time Virgin Money lent to this group of borrowers. That's what the rules of mortgage regulation say should happen, and that's what Virgin Money did. Mr B and Mrs H chose to end their mortgage early, knowing the price they would pay for doing so. It's not unfair they were charged that price.

My final decision

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 B and Mrs H to accept or reject my decision before 15 April 2024.

Simon Pugh
Ombudsman