DRN-4600700

The complaint

Miss G and Mr M say that Kensington Mortgage Company Limited has treated them unfairly. Because they are 'mortgage prisoners', Kensington has said they are ineligible for another interest rate product on their mortgage.

To settle the complaint Miss G and Mr M would like Kensington to switch their mortgage from the interest-only Standard Variable Rate (SVR) onto a capital repayment mortgage fixed for 5-15 years. Alternatively, they would like to sell the property and for Kensington to write off the negative equity, on the basis that 16 years of interest paid is already more than the amount they originally borrowed.

What happened

In 2007 Miss G and Mr M bought a property with a mortgage from a lender I will call GE. They borrowed £88,000 on an interest-only basis over a term of 35 years, plus fees of £2,550. The mortgage was later transferred to Kensington, and is a 'closed book' mortgage. The mortgage was initially on a fixed rate but after three years it moved onto a variable rate of 3.84% above Barclays Bank Base Rate. The mortgage is subject to GE's terms and conditions.

In 2011 Mr M moved out of the property. His name was later taken off the title deeds, but not the mortgage, which remains in joint names with Miss G. In 2016 Mr M bought another property in his sole name where he and Miss G now live.

In 2018 Miss G and Mr M asked Kensington for a new interest rate product and to convert the mortgage onto capital repayment. Kensington wasn't able to offer a new interest rate product but said it would allow Miss G and Mr M to switch to capital repayment. However, they decided not to at that time.

In July 2022 Miss G and Mr M asked Kensington for a new fixed rate product, and were told again that they weren't eligible and would need to seek independent financial advice.

Miss G and Mr M complained to Kensington. In addition to their dissatisfaction about not being able to switch to a new product, they also said the mortgage had been mis-sold. The complaint wasn't upheld, with Kensington explaining that it hadn't sold the mortgage, as it was taken out on the advice of Miss G and Mr M's own independent financial adviser (IFA). Kensington also said that Miss G and Mr M weren't eligible for a new interest rate product.

The complaint was referred to our service where an investigator looked at what had happened. Initially he didn't think Kensington had done anything wrong. However, after further consideration, he thought Kensington should allow Miss G and Mr M to apply for a new interest rate product.

This was on the basis of mortgage regulations which stated that borrowers in the same situation as Miss G and Mr M, who were unable to apply to a new lender for another mortgage because their existing mortgage had been securitised, shouldn't be treated less fairly than other borrowers with similar characteristics.

The investigator thought that, using a House Price Index (HPI), the property most likely had a loan-to-value ratio (LTV) of around 81%. (I will note here that recent property sales of similar properties in the same development suggested the property was more likely to be in negative equity.)

The investigator thought Miss G and Mr M should have been put on a lower rate when they asked in July 2022. The investigator didn't know what rates were available then, and thought Kensington should provide a breakdown of what was available, so that the mortgage could be re-worked from July 2022, and any overpayments refunded, with interest. He also thought Kensington should pay £400 compensation for distress and inconvenience, and that this should be split equally between Miss G and Mr M.

Kensington didn't agree with the investigator's findings. It explained that the reversionary rates on its fixed rate products were higher than the reversionary rate on the existing mortgage. Kensington argued that it wouldn't therefore be appropriate to allow Miss G and Mr M to apply for a new product which not only would come with an early repayment charge (ERC), but would commit them to a higher interest rate at the end of any fixed rate period.

The investigator didn't think this was a consideration, given that reversionary rates are subject to fluctuation and so Kensington's rate might have decreased in any event by the end of the fixed rate period.

As the matter is unresolved it falls to me to issue a decision.

Provisional decision of 15 January 2023

I issued a provisional decision in which I reached the following conclusions.

> First of all, I'm satisfied that Kensington did not sell this mortgage to Miss G and Mr M. They were advised to take out the mortgage by their own IFA. I understand the IFA is no longer in business and that Kensington have already provided Miss G and Mr M with details of the Financial Services Compensation Scheme.
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> It's correct that Miss G and Mr M fall within the definition of mortgage prisoners. They took out the mortgage with a lender that later securitised its mortgage book, and then transferred it to Kensington which now owns the mortgage. No further lending or interest rate products are available on this specific mortgage due to the loan having been securitised. In addition, because the property is in negative equity, Miss G and Mr M can't move to another lender.
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> I'm satisfied that in 2018 Kensington wasn't under any obligation to offer Miss G and Mr M a new product; this wasn't something that was available to them.
>
> Since 2018 the regulator looked at the situation borrowers such as Miss G and Mr M were in, and asked lenders to help, where possible. What this meant in practice was that if borrowers couldn't go to another lender, their existing lender would need to treat them the same as other borrowers with similar characteristics who were not mortgage prisoners.

This didn't mean, however, that mortgage prisoners should be treated *better* than existing customers, only that they should have the same access to interest rate products for which they qualified as other customers with similar age profiles, incomes, properties, credit risks and payment histories, and allow them to apply for a new product from Kensington's available range of interest rate products. This, however, would depend on there being an interest rate product for which Miss G and Mr M qualified.

Kensington offers a maximum LTV of 90% on its residential "Core" and "Select" products. Therefore Miss G and Mr M's property would need to be at a LTV of 90% or lower in order to qualify for a new product.

Miss G and Mr M have told us their property is in negative equity. The investigator thought, after looking at the HPI, that the LTV was around 80%. I've looked at the HPI used by the investigator. However, this is postcode-specific, rather than property-specific and so includes properties that are larger, and also includes houses rather than flats (the mortgaged property is a two-bedroomed flat). I'm not persuaded, therefore, that this particular HPI can be relied on.

I've also looked at recent sales of properties similar to Miss G and Mr M's, in the same street. I can see that one property sold for £65,000 in February 2022, another for £70,000 in October 2023 and a third for £75,000 in December 2023. These are all of a very similar type and layout to the mortgaged property. I'm therefore satisfied they are a more accurate comparison with Miss G and Mr M's property.

In the circumstances, I'm satisfied that it is more likely than not that Miss G and Mr M's property is also in negative equity, probably around 120-130%. This means that there is no product from Kensington's range for which they would qualify.

It follows, therefore, that I cannot order Kensington to offer Miss G and Mr M a new product. They aren't being treated differently from other customers with similar characteristics, because Kensington would not offer those other customers a new mortgage interest rate product either.

Responses to the provisional decision

Kensington accepted my provisional decision, but Miss G and Mr M did not. Mr M has made some further comments, which I summarise below.

- He doesn't feel that the complaint has been understood. Whilst Kensington may have used an index to value the property, or carry out a physical valuation, it didn't even get to that point because he and Miss G were told they were not eligible for a new product.

- Kensington failed to take any details of income, outgoings or property valuation, but simply said that it couldn't offer a new rate.

- If Kensington *had* valued the property, he would expect this would have shown negative equity, even though when they bought the property in 2007 it was the highest value as it has access to the loft.

- If Kensington had completed a valuation which showed negative equity, he'd have had the option to reduce the balance on the mortgage by about £10,000 by borrowing against his current home, in order to support Miss G continuing to live at the property and have an affordable mortgage.

- Kensington should have considered the application in 2022, but because it didn't, there was no assessment of eligibility criteria.

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 reviewed the file again from the outset, including the further comments made by Mr M.

The crux of this complaint is that Mr M says that when he enquired about a new fixed rate (Kensington's notes show this was on 8 July 2022) an application should have been allowed, rather than Kensington simply saying (as per the notes) that Mr M should take independent financial advice.

Mr M says that, if Kensington *had* considered an application, and it had been declined due to negative equity, he would then have been able to bring down the LTV by paying about £10,000 towards the capital balance, to enable Miss G to live in the property with a more affordable mortgage.

There's no obligation on lenders to offer new interest rates to their customers. A lender might legitimately choose not to offer rates to any customers. And where it does offer rates, it's fair and reasonable – and standard practice in the mortgage industry – for a lender to have eligibility criteria. These criteria might mean that not all borrowers are offered the same rate, or that some are not offered a rate at all, based on matters such as LTV and arrears history.

There are various reasons why Kensington has said it doesn't offer new interest rate products to customers whose mortgages were originally taken out with Miss G and Mr M's original lender, G.

Before 2017, Kensington did not offer new interest rates to existing customers. An existing customer whose introductory rate had expired and wanted a new rate would either have to move lender, or would have to re-apply to Kensington as a new customer for a new mortgage. From 2017, however, Kensington began to offer new interest rates to some existing customers. It has explained to us that its criteria for offering new rates are that:

- at the point at which the mortgage was taken out, the customer would have passed the affordability and regulatory requirements in place now;
- the customer's credit risk is in line with Kensington's current credit risk appetite;
- there is no history of arrears on the mortgage;
- the original mortgage lending was by Kensington – not another lender with the mortgage later moving to Kensington;
- the mortgage was taken out no earlier than 1 January 2010.

In this case, Miss G and Mr M's mortgage was taken out before 1 January 2010, and with a different lender.

Kensington says that, as part of its business model, it securitises its mortgages. This means it offers the beneficial interest in groups of loans to third party investors to raise funds for its ongoing mortgage business. This is a normal and legitimate feature of the mortgage industry, and it's not inherently unfair that Kensington operates its business in this way. But where a mortgage has been securitised, its terms are, effectively ‘set in stone’ and can’t be changed.

However, the Financial Ombudsman Service has in other cases taken the view that it’s unfair for borrowers to be refused a new rate because of this, where the borrower can’t move their mortgage to another lender or shop around for a better rate. So on the face of it, if Kensington was to say that Miss G and Mr M must remain on their current mortgage deal because of the way it has chosen to securitise the mortgage, and that in turn was based on with whom, when and how they took out the mortgage around 15 years before Mr M asked for a new rate in 2022, I would in all the circumstances consider this not to be a fair and reasonable basis to refuse to consider an application.

The rules of mortgage regulation, known as the Mortgages and Home Finance: Conduct of Business Sourcebook (MCOB), are found in the FCA Handbook. The relevant provision here is MCOB 11.8.1E (the E means it’s an evidential provision, not a rule). This says that, where a borrower is unable to move their mortgage to a new lender, their existing 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 contravention of Principle 6 (Customer’s interests).”

Principle 6 is another part of the FCA Handbook and says that a firm: *“must pay due regard to the interests of its customers and treat them fairly”*.

Whether or not a customer is deemed to have been treated unfairly will depend on the individual circumstances.

Because a rate switch isn’t possible on the specific mortgage Miss G and Mr M took out (as it was not with Kensington), the only way a new rate could be put in place would be by offering a new mortgage to replace the old one. That would depend on Kensington offering a mortgage for which Miss G and Mr M would be eligible, not just in terms of LTV, but other criteria.

Even if Mr M paid £10,000 off the balance by raising this against his current property, I don’t think that he and Miss G would have qualified for another residential mortgage from Kensington. That’s because Kensington’s maximum LTV is 90% for its residential mortgages, so paying off £10,000 wouldn’t bring the account balance within that percentage. In addition, Kensington residential mortgages are only available on the borrower’s main residence, and the secured property isn’t Miss G or Mr M’s main residence.

Given this, I’m satisfied that, even if Kensington had considered offering another mortgage from its product range in July 2022, Miss G and Mr M wouldn’t have qualified for it, on LTV alone. Kensington isn’t obliged to offer mortgages outside its product range or create a bespoke product for Miss G and Mr M if they don’t meet the criteria for its existing products. Were it to do so, it would be treating Miss G and Mr M *more* favourably than other customers with similar characteristics.

Kensington has also agued that the follow-on rate for its mortgages is higher than the rate Miss G and Mr M are currently on, and so it wouldn’t be appropriate to offer them a mortgage which ultimately might be more expensive than their existing one. If they’d met eligibility criteria for a Kensington mortgage, that’s a decision Miss G and Mr M would have had to weigh up. But this is a moot point in any event, as they wouldn’t have qualified for a new Kensington product.

In the circumstances, Kensington probably should have looked at whether another product in its range would have been suitable when Mr M asked in July 2022, and on the face of it, Kensington acted unfairly in not considering whether it could have offered another product. However, I'm satisfied that, even if Kensington *had* considered an application, the outcome would not have been any different because Miss G and Mr M would have been outside the maximum LTV in any event and so would not have been eligible. Given this, although there was unfairness, it has not resulted in any loss or detriment to Miss G and Mr M.

There is, of course, nothing to stop Miss G and Mr M from applying again to Kensington for a new product, and, given the stance our service has taken in relation to borrowers in similar positions, we'd expect Kensington to at least consider an application. But I think that the LTV and the fact that the property is no longer their main residence are material factors that are probably going to mean that Miss G and Mr M wouldn't meet eligibility criteria for a new residential mortgage.

I appreciate that this isn't the outcome Miss G and Mr M were hoping for. But I can't force Kensington to offer a mortgage outside of its product portfolio if Miss G and Mr M don't meet eligibility criteria.

I think it might be helpful for Miss G and Mr M to speak to an independent financial adviser about their options. I'm not sure Miss G, as the property owner, would meet most lenders' criteria for a new buy-to-let mortgage, as the maximum allowable LTV is generally lower than for residential mortgages. Because Mr M is no longer on the title deeds, he would not be able to re-mortgage a property he doesn't own. But there may be other options, which is why speaking to a financial adviser might be a good idea.

My final decision

My final decision is that I don't uphold this complaint.

This final decision concludes the Financial Ombudsman Service's review of this complaint. This means that we are unable to consider the complaint any further, nor enter into any discussion about it.

Under the rules of the Financial Ombudsman Service, I'm required to ask Miss G and Mr M to accept or reject my decision before 4 March 2024.

Jan O'Leary
Ombudsman