

## **The complaint**

Mr and Mrs P complain that the early repayment charge (ERC) HSBC UK Bank plc required them to pay on redemption of their mortgage was unfairly high and didn't reflect the cost to the bank of early repayment.

## **What happened**

Mr and Mrs P took out their mortgage with HSBC in 2015, on a fixed interest rate for the first five years. On expiry of that fixed rate in 2020 they took a new fixed interest rate of 1.36% for another five years, until 31 July 2025. An ERC was payable if the mortgage was repaid in full during the fixed rate period.

In 2023 Mr and Mrs P decided to sell the mortgaged property and repay the mortgage. In August 2023 they made a complaint to HSBC about the level of the ERC, because they didn't think it reflected the cost to HSBC of early repayment. They went on to repay the mortgage in September 2023, paying an ERC of £9,696.88.

In response to Mr and Mrs P's complaint, HSBC said the ERC wasn't a penalty, it was clear in the mortgage contract, and it was entitled to base the ERC on a reasonable pre-estimate of its costs if a mortgage is repaid early across a group of mortgages rather than for Mr and Mrs P's mortgage individually. It wasn't prepared to waive the charge.

Mr and Mrs P referred their complaint to the Financial Ombudsman Service. Our Investigator didn't think HSBC had done anything wrong, so he didn't recommend that it refund any of the ERC or otherwise compensate Mr and Mrs P.

Mr and Mrs P didn't accept that conclusion and asked for an Ombudsman's review. They weren't persuaded that HSBC had fairly calculated its costs and they didn't think the Investigator had assessed the matter objectively.

## **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.

The ERC was set out clearly in the mortgage offer Mr and Mrs P accepted in 2020. It was payable if Mr and Mrs P repaid their mortgage in full during the fixed interest rate period, which ended on 31 July 2025. The offer said, at section 7, that the ERC would be:

calculated at 1.00% per each remaining full year in the period (for part years, this is calculated on a pro-rata basis), based on the amount repaid early above the annual overpayment allowance

It also set out the maximum ERC that could be payable in cash terms.

Mr and Mrs P accept that they knew about the ERC. The offer explained the circumstances in which it would be payable and how much it could cost. Mr and Mrs P also knew what the

cost would be before they repaid the mortgage. They don't, however, accept that the ERC is a reasonable pre-estimate of the cost to HSBC of early redemption and they say the ERC is therefore unenforceable. In particular, they say that HSBC's modelling must wrongly assume that interest rates would remain low, because it could now re-lend the money they had been paying 1.36% interest on at a much higher rate of more than 5%. On that basis, they consider that repaying the mortgage early benefited rather than cost HSBC, and that it is profiteering from recent increases in rates by continuing to charge ERCs at the same level it was charging in 2020.

I've carefully considered the points Mr and Mrs P have made. HSBC can't just set its ERCs at whatever level it likes. It must follow the rules of mortgage regulation. Those rules (the Mortgage Conduct of Business rules, known as MCOB) include, at MCOB 12.3, provisions about ERCs. In summary, they say that an ERC must be able to be expressed as a cash value, and must be a reasonable pre-estimate of the costs resulting from early termination of the mortgage.

They also say that a lender can choose the method it uses to calculate an ERC, and it can calculate the same level of ERC across a group of mortgages of a similar type, rather than for an individual mortgage with an individual borrower.

This means that HSBC can set an ERC based not on the actual cost to it of Mr and Mrs P redeeming their mortgage early, but on a reasonable pre-estimate of the costs of early termination of a group of mortgages of a similar type. HSBC can't know in advance whether or not an individual borrower will end their fixed rate early, and if so when. So it can't estimate in advance the costs of ending a particular mortgage early. But it can estimate how many borrowers, on average, will do so – and apply those costs across a group of mortgages.

HSBC has sent us information about how its pre-estimate of loss on mortgages of the type Mr and Mrs P held was calculated. It has done so in confidence. I realise that Mr and Mrs P consider that this is unfair and that they should be entitled to see and comment on the calculations. But the rules of the Financial Ombudsman Service allow either party to a complaint to submit evidence in confidence. It's then for us to decide whether to treat that evidence as confidential. HSBC has given us detailed information about how it funds its mortgages, how its business is organised, and what its various costs are. That information is commercially sensitive and confidential. It's also material and relevant to this complaint. For those reasons, I'm satisfied that it's appropriate for me to receive it in confidence.

In summary, the information shows that there's a cost to HSBC in raising the money it lends, and in carrying out the activities around lending. It recoups that cost through the lending. HSBC allocates that cost across its mortgages in the expectation that a certain proportion will end before the fixed rate period ends, and the cost allocated to those is estimated to reflect the losses to HSBC from the interest it will no longer receive from those mortgages and the resulting cost of unwinding its own funding arrangements.

So the ERC HSBC charged Mr and Mrs P when they repaid their mortgage wasn't calculated to reflect its losses, if any, on their particular mortgage. It was calculated at the level it was to reflect a share of the total losses HSBC estimated it would incur if the number of mortgages it expected ended early. This was done when HSBC set the ERC in 2020.

This is a reasonable way of setting an ERC. It's in line with the regulator's rules, which allow an estimate to be used, and which allow that estimate to be set across a portfolio of mortgages rather than on an individual basis. The rules allow that estimate to be a *pre*-estimate, so there was no requirement that HSBC review or adjust the ERC that was set out in Mr and Mrs P's mortgage agreement later in response to changing conditions in the

mortgage market or the wider economy. And in any event it's not necessarily the case that HSBC can simply lend those funds out to another customer at a higher fixed rate now – since its own funding is over a specified period and therefore can't be re-lent now over a longer period without cost. HSBC's methodology is also broadly in line with that of the wider industry. The price of a mortgage, both the interest rate and the ERC, are set at a level that allows the lender to recover its costs – and the portfolio approach is a reasonable one to take.

I don't think the ERC is a penalty as Mr and Mrs P have said, and I've noted what they've said about a staff member at HSBC having referred to the ERC as a fine during a phone call. But a penalty has a specific meaning – a sum charged if a contract is broken. An ERC isn't a penalty, because ending the mortgage early isn't a breach of contract. It's something specifically allowed for in the contract – at the price set out.

For the reasons I've explained, I don't find that HSBC did anything wrong in calculating the ERC on Mr and Mrs P's mortgage in the way it did or in requiring Mr and Mrs P to pay it when they redeemed their mortgage.

### **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 P and Mrs P to accept or reject my decision before 22 August 2024.

Janet Millington  
**Ombudsman**