

The complaint

Mr and Mrs D complain that Mortgage Agency Services Number Five Limited (MAS5) unfairly increased the interest rate on their mortgage, meaning they were overcharged interest over many years. They complain it's taken advantage of them because they're unable to move their mortgage elsewhere.

What happened

Mr and Mrs D took their mortgage out with another lender, GMAC-RFC Ltd, in 2007. They borrowed £144,000 on interest only terms over 25 years. Their mortgage was on the standard variable rate (SVR) from the start, with a discount of 1.25% until 30 June 2009 and without a discount thereafter. At the time they took the mortgage out, the SVR was 7.49%, meaning the initial interest rate Mr and Mrs D were required to pay was 6.24%.

Shortly after Mr and Mrs D took the mortgage out, it was transferred (with other GMAC mortgages) to MAS5. MAS5 has been their lender ever since.

The interest rate Mr and Mrs D have paid has varied over the years. Until early 2009, it changed at around the same time as, and by the same amount as, the Bank of England base rate – though there's no direct linkage between the SVR and base rate. In 2009, MAS5 increased the SVR on two occasions even though base rate hadn't changed. It increased the SVR again in 2011 and 2012, again without there being changes to base rate at those times.

There were no further changes to the SVR until 2016. Between 2016 and 2022, MAS5 changed the SVR at the same times and by the same amount as changes to base rate. More recently it has increased the SVR in line with increases to base rate – other than a period between August and November 2022, when it didn't pass on base rate increases in full.

Mr and Mrs D complained about their interest rate. They said that the changes MAS5 had made – especially the increases between 2009 and 2012 – weren't fair and meant that they'd been overcharged. They also said that MAS5's SVR shouldn't be higher than the SVR charged by The Co-operative Bank plc – The Co-op is a separate firm, but owns MAS5. And they said that MAS5 had treated them unfairly and had taken advantage of them because they were unable to move their mortgage to another lender.

Our investigator said that we could only consider the fairness of the interest rate charged in the six years before Mr and Mrs D complained. But he said that in doing so, he would need to take into account all the changes MAS5 had made, even if they took place more than six years ago, to the extent that they impacted on and were relevant to the fairness of the interest charged within the six year period.

The investigator went on to say that he didn't think it was fair that MAS5 had charged interest within the last six years leading up to Mr and Mrs D's complaint that took account of the increases in 2011 and 2012. He said that MAS5 should reduce the interest charged from 1 June 2016 (six years before the complaint was first made) to November 2022 by 1.25%, as if those two increases had never happened. That's because after November 2022 the

interest rate was no longer unfair, because MAS5's decisions not to pass on the changes in base rate at that time offset the earlier unfairness.

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 first thing to say is that, although The Co-op owns MAS5, they are separate firms with different types of mortgages. Mr and Mrs D's mortgage is with MAS5, not The Co-op, and the SVR charged by The Co-op isn't applicable to their mortgage – nor is any difference between the two a basis for considering whether the MAS5 SVR is fair or not. Rather, I'll need to consider any changes MAS5 itself has made to the rate it charges Mr and Mrs D and whether that has resulted in them being treated fairly or not.

Mr and Mrs D have complained about the interest rate before. MAS5 sent them a final response on 14 February 2013 in which it didn't uphold their complaint and told them they had six months to refer it to the Financial Ombudsman Service if they remained unhappy. Because Mr and Mrs D didn't refer their complaint to us at the time, a complaint about interest charged before then is now out of time.

Mr and Mrs D made this complaint on 1 June 2022. I therefore agree with our investigator that we can consider the fairness of interest charged since 1 June 2016, six years before the complaint. But we can't go back any further than that, because Mr and Mrs D were clearly aware of cause for complaint – as shown by their complaint in 2013 – and there are no exceptional circumstances which explain why they couldn't have complained sooner.

But in considering the part of the complaint that's in time, I'll need to take account of all the circumstances, including actions by MAS5 before that date, insofar as they're relevant to the fairness of the interest charged from 1 June 2016 onwards. What follows is my findings on the merits of that part of the complaint.

The interest rate charged to Mr and Mrs D is determined by the mortgage offer and the terms and conditions. The original GMAC mortgage offer said they would be charged the SVR with an initial discount rate, followed by the undiscounted SVR from 30 June 2009. Mr and Mrs D's mortgage has in fact operated in this way – they been charged the MAS5 SVR with an initial discount, and then without discount from 1 July 2009.

While MAS5 didn't offer Mr and Mrs D a new interest rate after 2009, it wasn't required to do so and didn't promise that it would. It didn't offer new rates to any customer, so Mr and Mrs D weren't treated less favourably than other customers with similar characteristics to them. MAS5 didn't put any barriers – such as an early repayment charge (ERC) – in the way of them moving this mortgage to another lender either. In all the circumstances, I don't think it was unfair that Mr and Mrs D were charged the SVR rather than being offered a new preferential interest rate.

Mr and Mrs D have explained that they felt they were trapped with MAS5 and unable to move the mortgage elsewhere, so they had no choice but to pay the SVR. They've explained that when they tried to do so, they were unable to because of the affordability requirements imposed by other lenders – changed circumstances since the mortgage was taken out mean they now struggle to meet affordability assessments even though this mortgage is up to date and they've made a series of lump sum overpayments.

MAS5 wrote to Mr and Mrs D in December 2019, inviting them to apply to move their mortgage from MAS5 to The Co-operative Bank plc. It wrote again in March 2020, and

Mr and Mrs D arranged an appointment for 26 March 2020. MAS5's notes say that their application was refused because of affordability concerns. As this was an application to The Co-operative Bank plc to offer them a new mortgage to replace the MAS5 one, any complaint about the refusal to offer a new mortgage would need to be made to The Co-op, not MAS5, as it was The Co-op's decision to refuse their application.

The same is true of any applications to other lenders, outside the Co-op group. I can understand Mr and Mrs D's frustration about being unable to move elsewhere. But, as I've said, MAS5 didn't put barriers in their way, and it's not responsible for the affordability assessments other lenders carry out. So it didn't prevent them moving elsewhere – indeed, it has from time to time written to them to point out that they might be better off doing so if they can. However, because Mr and Mrs D were in fact unable to shop around and move to another lender, there was a special obligation on MAS5 to treat them fairly and not take advantage of their situation.

While it wasn't unfair that Mr and Mrs D remained with MAS5 on the SVR, it's important that the SVR itself was set at a fair level – in particular, in the way MAS5 changed it over the years.

After Mr and Mrs D took out the mortgage, MAS5 reduced the SVR significantly in line with changes in the Bank of England base rate. Between 2009 and 2012, it then increased the SVR again – this time at a time when base rate was unchanged.

MAS5's ability to change the SVR is governed by the terms and conditions, which say:

3.1 If the interest rate is the standard variable rate we may vary it for any of the following reasons:

- (a) to reflect a change which has occurred, or which we reasonably expect to occur, in the Bank of England base rate or interest rates generally;
- (b) to reflect a change which has occurred, or which we reasonably expect to occur, in the cost of the funds we use in our mortgage lending business;
- (c) to reflect a change which has occurred, or which we reasonably expect to occur, in the interest rates charged by other mortgage lenders;
- (d) to reflect a change in the law or a decision by a court; or
- (e) to reflect a decision or recommendation by an ombudsman, regulator or similar body.

When it increased the SVR between 2009 and 2012, MAS5 relied on condition 3.1 (b) – to reflect a change which had occurred, or which it reasonably expected to occur, in the cost of funds it used in its mortgage lending business.

As I've explained, a complaint about the increases between 2009 and 2012 is out of time – so I can't consider the increases as complaints in their own right. But they do form part of all the circumstances relevant to what's fair and reasonable in respect of the interest charged from 1 June 2016 onwards. So I will still need to consider the fairness of those increases insofar as they impacted the interest charged during that period.

MAS5 said that it relied on condition 3.1(b), cost of funds, to increase the interest rate between 2009 and 2012. I've reviewed the evidence MAS5 has provided about this, and I'm not persuaded that MAS5's cost of funds actually did increase at these times – or that it

could, at the relevant times, have had a reasonable expectation that such an increase was likely. That's because the way that MAS5 had structured its mortgage lending business meant that it wasn't subject to wider market pressures and so its own funding costs didn't change – even if the costs faced by the wider banking group of which it was a part did.

I'm not therefore persuaded that the contractual basis MAS5 relied on to increase the SVR at these times was valid. Taking that into account, I then need to think about whether it acted fairly and reasonably in all the circumstances in charging the interest that it did during the period I can consider.

In looking at all the circumstances, I think it's relevant to take into account that, as part of the transfer of mortgages – including this one – from GMAC to MAS5, MAS5 agreed that it would maintain the SVR at a level not more than 2% above base rate.

This covenant was between GMAC and MAS5, and Mr and Mrs D weren't party to it. It didn't change the terms of the mortgage.

Under the terms and conditions, MAS5 was permitted to vary the SVR for a number of reasons, including to reflect changes to base rate – but it wasn't required to reduce the SVR when base rate reduced. In agreeing to the covenant, MAS5 agreed to restrict its ability to change the SVR beyond that set out in the mortgage terms and conditions.

The result was that, by the time the covenant came to an end in 2009, the SVR had fallen to 2.99%. The SVRs of virtually all other lenders also fell at this time – but they didn't fall to the same extent, because mortgage funding costs didn't reduce by as much as base rate reduced during the financial crisis. The result was that, because of the covenant, MAS5's SVR fell by more than it would otherwise have done, and ended up lower than it otherwise would have done, and lower than the SVRs of comparable lenders.

When MAS5 increased the SVR in 2009, it did so from the low level caused by the existence of the covenant. The 2009 increases essentially restored the SVR to what it would have been had the covenant not existed, and had the SVR not reduced as much as it did because of the covenant.

As I say, Mr and Mrs D weren't party to the covenant. It was an agreement between MAS5 and GMAC which meant that their interest rate reduced by more than it would have done had their mortgage remained with GMAC, and more than it would have done without the covenant. It meant that their interest rate reduced to a level lower than would have been expected based on the operation of the mortgage terms and conditions alone.

To that extent, the reduction in SVR driven by the covenant benefitted Mr and Mrs D, because it meant they paid a lower interest rate than they would otherwise have done.

I think that's a relevant factor to take into account when considering whether the later interest rate, charged as a consequence of (among other factors) the 2009 increases was fair. Although MAS5 had no contractual basis for increasing the SVR when it did, those increases corrected for the SVR being at an artificially low level. To require MAS5 to reduce the later interest rate as if those increases had never taken place would be to require it to continue implementing the covenant after it no longer existed, and to implement an interest rate lower than Mr and Mrs D could have expected by the operation of the terms and conditions of their mortgage alone. I think that would represent over-compensation.

The same considerations don't apply to the 2011 and 2012 increases. The covenant no longer had an impact. So in this respect, I don't think it would be unfair to require MAS5 to reduce the later interest rate as if those increases had never happened.

In summary, therefore, my findings are:

- The increases in 2009 to 2012 are out of time and cannot be considered as complaints in their own right.
- But it wasn't fair and reasonable for the SVR charged after 1 June 2016 to be set at a level which reflected the increases in 2011 and 2012, because there was no contractual basis for those increases and it wouldn't therefore be fair for MAS5 to rely on them in charging interest in the period I can consider.
- But in respect of the increases in 2009, the same doesn't apply – because prior to those increases the SVR was lower than it would otherwise have been, and lower than Mr and Mrs D could reasonably have expected by operation of the mortgage agreement alone, because of the restrictive covenant. To require MAS5 to reduce the SVR as if the covenant was still in place after 2016 would not represent fair compensation.

To put matters right, MAS5 should refund interest charged as a result of both the 2011 and 2012 increases. That means it should refund 1.25% interest, in respect of interest charged from 1 June 2016 onwards.

MAS5 now accepts this, but says that the refund of interest should only apply until November 2022. That's because between August 2022 and November 2022 it didn't increase the SVR even though the Bank of England base rate increased at those times – which had the effect of removing the lingering unfairness of the 2011 and 2012 increases.

I've thought carefully about this, and I'm persuaded by what MAS5 says. The effect of my redress award is that the MAS5 SVR should have been 1.25% lower than it actually was. I'm persuaded that if the SVR had been 1.25% lower in 2022, it's likely that MAS5 would have chosen to pass on the base rate increases rather than absorb them – as it would have been entitled to do under condition 3.1 (a). With the redress in place, the SVR would have been lower than many mainstream lenders, and lower than other firms in the wider banking group.

But – as a group – MAS5's mortgages are generally higher risk than those of mainstream lenders and of other parts of the wider banking group. That means they're more likely to go into arrears or default, increasing the costs to MAS5 if that happens.

It's standard practice, and not unreasonable, to include an element of "pricing for risk" in setting interest rates. While the terms and conditions don't allow MAS5 to increase the interest rate for this reason, they do allow it to increase the interest rate to reflect changes in base rate. I'm satisfied that if the interest rate had been 1.25% lower – as is the case following my redress award – then MAS5 would have passed on the base rate increases, as it would have been entitled to do.

Therefore, to require MAS5 to continue the interest rate refund beyond November 2022 would require it to treat Mr and Mrs D's mortgage as if the 2011 and 2012 increases had never happened, *and also* as if the 2022 base rate cuts had not been passed on. I don't think it's likely that their mortgage would ever have been in a position where both those things happened, and therefore to require MAS5 to do that would be over-compensation.

I do understand the impact recent interest rate rises have had. However, that's driven by recent economic conditions. MAS5 has increased the SVR to reflect changes in base rate, as it's entitled to do under the terms and conditions, and the result is not out of line with that of other comparable lenders. I don't think there's any basis on which I can fairly ask it to reduce the interest rate charged after November 2022.

MAS5 have offered to re-work Mr and Mrs D's mortgage account by reducing the rate on the mortgage by

- 1.25% from 1 June 2016 to 30 August 2022;
- 0.75% from 1 September 2022 to 31 October 2022;
- 0.25% from 1 November 2022 to 30 November 2022.

The gradual change in the rate is a result of the timings of the changes MAS5 said it would have made had the rate been 1.25% lower before 2022. This reflects the fact that base rate increased by 0.5% in August and September 2022 – neither of which were passed on but would have been had the rate been lower.

As I've explained, I'm satisfied that this is what MAS5 would have done, had it not been charging Mr and Mrs D an unfairly high rate prior to 2022. And so I'm satisfied the offer it's now made puts them back in the position they would have been in, had MAS5 applied a fair rate of interest from 1 June 2016.

Mr and Mrs D have said that the redress payment should be backdated to November 2022. But I don't think that's right, and I don't think that would benefit them in the way they think it would. MAS5 will need to give them the option of having the overpaid interest refunded to them, or having it used to reduce the balance.

If they select the refund option, MAS5 will also pay simple annual interest of 8% running from the date of each month's overpayment to the date of refund. This results in interest being paid over a longer period than if the redress was applied as at November 2022.

And if they select the overpayment option, then their balance will be reduced each month as if they'd overpaid at the time. This has the compounding effect of reducing their balance there and then, resulting in a lower balance – and so less interest being charged, and a bigger overpayment, the next month. And so on through the six years. This means that Mr and Mrs D will get the benefit of the overpayments as they made them – which has a bigger impact on their mortgage than if the cumulative overpayments had been applied as a lump sum in November 2022. This option will also factor in the voluntary overpayments they've made.

I'm therefore satisfied that either of these options represents fair compensation, and I leave it to Mr and Mrs D to notify MAS5 which they'd prefer.

I haven't awarded further compensation on top of the refunded interest. Mr and Mrs D were able to maintain their monthly payments – and make regular overpayments – throughout the period I can consider, so the additional interest didn't cause them particular hardship at the time – and nor, as I explained above, was it the cause of them being unable to move to another lender.

My final decision

My final decision is that I uphold this complaint and direct Mortgage Agency Services Number Five Limited to reduce the interest rate charged to Mr and Mrs D in the way I've set out above, and give Mr and Mrs D the choice of:

- Having the resulting overpayments used to reduce their mortgage balance from the month of each overpayment, reducing subsequent interest charged accordingly; or

- Having the resulting overpayments refunded to them, adding simple annual interest of 8% running from the date of each month's overpayment to date of refund. If Mr and Mrs D select this option MAS5 may deduct income tax from the 8% interest element of my award, but should tell them what it has deducted so they are can reclaim the tax from HMRC if they are entitled to do so.

Whichever option Mr and Mrs D select, MAS5 should write to them explaining the calculations it has carried out, and setting out their revised mortgage balance and monthly payment if they select the overpayment option.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs D and Mr D to accept or reject my decision before 18 July 2024.

Simon Pugh
Ombudsman