DRN-5688828

The complaint

Mr and Mrs G complain about how Lloyds Bank PLC trading as Scottish Widows Bank ("SW") managed their offset mortgage. They didn't expect to pay interest on their mortgage when rates rose, as it was fully offset. They said SW should've warned them it would charge.

What happened

Mr and Mrs G said the fixed interest rate on their mortgage came to an end in late 2024. They were aware this would cause a large increase in their mortgage rate, if they went onto SW's Standard Variable Rate ("SVR") but said they weren't worried about this, because their mortgage was fully offset. They had increased the balance in their offset savings account on 15 October, to make sure the mortgage was fully offset before the rate changed.

On 7 November, SW wrote to Mr and Mrs G to tell them their December payment would be well over £2,000. Mr and Mrs G complained.

SW has explained to Mr and Mrs G that their offset mortgage is working in line with the terms of the account. The savings they have with SW in their offset savings account, accrue interest at the same level as the current mortgage interest rate. But savings interest accrued in month one is then used to pay the mortgage interest charge for the next month (month two) and any remaining money due is then collected in the following month (month three). So here, savings interest earned in October, would be used to pay the mortgage interest due for November, and collected in December.

And there are two important things to bear in mind about Mr and Mrs G's offset savings account in October 2024.

One was that, in October 2024, Mr and Mrs G only earned interest on their savings in line with their previous, rather lower, fixed rate. And the other was that the amount of money in their offset savings account was then a bit less than their mortgage. This mortgage wasn't fully offset until they made a further payment into their offset savings account on 15 October. So the interest earned on their offset savings in October was then used to pay part of the interest for November 2024, which was charged at the much higher SVR.

The savings interest earned in October 2024 didn't cover all the interest charged for November 2024, for the two reasons set out above. That meant Mr and Mrs G had to make a sizeable payment in December 2024.

Payments didn't continue at this level. After this, Mr and Mrs G's savings interest earned and mortgage interest charged were more closely aligned.

SW didn't think anything had gone wrong with Mr and Mrs G's mortgage, so it wouldn't pay back the money they'd paid in December 2024. It did offer £50 for some service failings, which Mr and Mrs G turned down.

Mr and Mrs G have said that if they'd realised this was how their mortgage worked, they would have made sure their offset savings balance was the same as their mortgage balance a couple of weeks earlier. And they would have taken out a new fixed rate. Those two steps would have reduced the interest they were charged in December 2024.

Mr and Mrs G said SW should just have reminded them how this mortgage works, when it wrote to tell them about the interest rate change – or indeed, any of the many other times SW had written to them since their mortgage started. They said SW had written to them hundreds of times about their mortgage, and they couldn't find an explanation of how this mortgage actually worked in any of those letters. They sent us a selection of this correspondence, so we could see.

Mr and Mrs G said it was unreasonable for SW to expect them to remember something like this from years ago when their mortgage was first taken out. And they said SW had told them there are lots of complaints about the same issue, so Mr and Mrs G felt SW should be warning its offset mortgage holders that they can face a large monthly payment at least once when interest rates rise.

Mr and Mrs G wanted SW to refund the extra amounts they were charged in December 2024, and update its regular letters to explain how these offset mortgages actually work. Our investigator didn't think this complaint should be upheld. He said SW was operating the offset mortgage in line with its terms, and the broker that Mr and Mrs G took their mortgage out with should have explained those terms to them.

SW broadly agreed with that. It said borrowers can look up their mortgage terms if they want to, but it doesn't randomly inform customers of the existing terms and conditions of their mortgage when those conditions have not changed.

Mr and Mrs G disagreed, saying they now understood SW was operating this mortgage as it should, but they still thought SW should have warned them. They wanted to stress just how many opportunities SW had to remind them how the offset mortgage worked. Those opportunities were not limited to the letter telling them of the upcoming rate change, but also encompassed every contact Mr and Mrs G had with SW to make a payment into their offset account, and the many payment confirmations it had sent them over the term of the mortgage.

Mr and Mrs G said SW knew this was a common problem. It happened often enough that the complaint handler who took their complaint said it wouldn't be upheld, because no one else's complaint about the same thing had been upheld. So Mr and Mrs G asked why SW was doing nothing to help its borrowers to understand their mortgages, and solve this problem.

Because no agreement was reached, this case 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. This is what I said then:

> I do think SW has managed Mr and Mrs G's mortgage in line with its terms. So the interest they were charged on their mortgage in December 2024, was due because their mortgage wasn't fully offset until 15 October, and because the interest earned on their offset savings at 3.22% in October wasn't enough to cover the interest charged on their mortgage at 8.49% in November.
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> Previously, Mr and Mrs G focussed on whether SW had explained to them how this mortgage works, at key points in the history of the account. More recently, Mr and Mrs G

have also said they think how this offset mortgage works is fundamentally unfair. They don't think SW should be able to charge them, each time interest rates go up, if their mortgage is fully offset.

I hope I've explained fully here that this is in line with how this mortgage works. I don't think it is unfair or unreasonable for this mortgage to operate like this. If Mr and Mrs G now think that they wouldn't have taken this mortgage out if they'd understood this from the outset, then that wouldn't be SW's fault. I don't think it was SW's responsibility to explain this mortgage to them when they took it out, as I understand it was taken out through a broker.

But I also understand why Mr and Mrs G are upset by what has happened. They had clearly been managing their mortgage in anticipation of a change in interest rates, and fully offset their mortgage in mid-October 2024. So they were not expecting a sizeable monthly charge in December 2024, as a result of their mortgage going onto the SVR.

Mr and Mrs G could not have avoided being charged at all in December. Rates as low as their previous fixed interest rate were very unlikely to have been available to them then, so they would always have seen a charge for interest in December 2024.

But Mr and Mrs G could, if they'd been informed about how this mortgage works, have taken two steps to reduce this charge.

Firstly, they could have moved extra savings into their offset account at the end of September, instead of midway through October 2024. I've checked with Mrs and Mrs G, and they've shown us they had the funds available in a current account at the time, to do this.

Secondly, they could have taken out a new fixed interest rate, in late September after SW wrote to remind them their existing fixed rate was coming to an end. Mr and Mrs G haven't suggested they plan to redeem this mortgage soon, so they could have taken out a two year fixed rate, and may well have chosen to do that in late 2024. (I note, however, that Mr and Mrs G are now unsure if they would wish to be tied to SW for the future, now they understand this mortgage better, so it's not yet clear whether this should form part of the redress in this case.)

Although SW has rowed back somewhat from the comments made by its complaint handler, indicating that this problem is seen often, it's not unusual for our service to see complaints made by people who have not understood how this particular type of offset mortgage works.

I would not suggest that SW has a general duty to remind its customers of their mortgage conditions. However, I think that there were two key opportunities to remind Mr and Mrs G of how this sort of mortgage works, at particularly relevant times, which would have assisted Mr and Mrs G in understanding how this mortgage works.

One was when Mr and Mrs G were making payment to their offset account. Any payment confirmation issued by SW at that time could have reminded Mr and Mrs G that a payment made into their offset account in month one, would only start to benefit the payer in month two, which would then be reflected in the payment requested for month three.

And the other is when Mr and Mrs G were approaching the end of their fixed interest rate deal. The letter issued then could have warned Mr and Mrs G that the earnings on their offset savings account run behind the interest charges on their mortgage, so they should anticipate a larger payment in the first month after rates go up, and this remains the case even if the mortgage is otherwise fully offset.

I've taken that into account. I've also taken the Consumer Duty to support consumer understanding into account – requiring SW to give Mr and Mrs G clear, fair and not misleading information enabling them to make timely and effective decisions in the management of their mortgage. And I've taken into account that this is a relatively complex product about which SW – not Mr and Mrs G – is the expert. In not drawing their attention to how their mortgage worked, and in particular not explaining the specific impact interest rate changes would have on their offset account, I don't think SW treated them fairly. So I think SW should offer to put Mr and Mrs G back in the position they could have been in, if they'd been better informed in September and October 2024, and it should pay some compensation too.

To put things right, SW must do the following –

- rework Mr and Mrs G's mortgage as if the payment into their offset account made on 15 October 2024, had been made on 30 September 2024.

- within two weeks of the date of my final decision, provide Mr and Mrs G with the details of the two year fixed interest rate deal or deals that they could have secured with SW on 30 September 2024 – to include the rate, the Early Repayment Charge, and any fee incurred. If Mr and Mrs G select one of those rates within a month of being provided with these details, then SW must rework their mortgage as if this rate had been applied on 1 November 2024. (If Mr and Mrs G don't select a new rate, SW doesn't have to apply this new interest rate, and Mr and Mrs G are free to remortgage elsewhere.)

- if either of the above recalculations produces an overpayment, SW should give Mr and Mrs G the choice of having the overpayment(s) used to reduce their mortgage balance with effect from the date of overpayment, or of having the overpayments refunded to them. If they select the refund option, SW should add simple annual interest of 8% running from the date of overpayment to the date of refund. It may deduct income tax from the 8% interest element (if applicable) but should give Mr and Mrs G a tax certificate so they can reclaim the tax from HMRC if they are entitled to do so.

- pay Mr and Mrs G the sum of £50 previously offered (if this has not already been paid) for elements of poor service in the response to their complaint.

-pay Mr and Mrs G £200 for the distress and inconvenience caused to them by the events which are the subject of this complaint.

I think that would provide a fair and reasonable outcome to this complaint.

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.

SW replied to say it would accept the provisional decision. Mr G replied, to say he thought I had clearly understood the situation, but he still thought SW had come up with a product that was unfair to its customers. He said it was impossible for customers not to incur higher interest charges when interest rates go up, but it would not pass on the benefit to customers when rates go down. He thanked me for my help so far.

I understand that Mr and Mrs G remain unhappy with the mortgage product that they have, and I appreciate the reasons they would take that view. But I've explained in my provisional decision that I don't think it's unfair or unreasonable for this mortgage to work as intended. I still think that the mistake SW made here, was in not explaining this more clearly to Mr and Mrs G at key points. So I haven't changed my mind. I'll now make the decision I originally proposed.

My final decision

My final decision is that Lloyds Bank PLC trading as Scottish Widows Bank must do the following –

- rework Mr and Mrs G's mortgage as if the payment into their offset account made on 15 October 2024, had been made on 30 September 2024.

- within two weeks of the date of my final decision, provide Mr and Mrs G with the details of the two year fixed interest rate deal or deals that they could have secured with Lloyds Bank PLC trading as Scottish Widows Bank on 30 September 2024 – to include the rate, the Early Repayment Charge, and any fee incurred. If Mr and Mrs G select one of those rates within a month of being provided with these details, then Lloyds Bank PLC trading as Scottish Widows Bank must rework their mortgage as if this rate had been applied on 1 November 2024. (If Mr and Mrs G don't select a new rate, Lloyds Bank PLC trading as Scottish Widows Bank doesn't have to apply this new interest rate, and Mr and Mrs G are free to remortgage elsewhere.)

- if either of the above recalculations produces an overpayment, Lloyds Bank PLC trading as Scottish Widows Bank should give Mr and Mrs G the choice of having the overpayment(s) used to reduce their mortgage balance with effect from the date of overpayment, or of having the overpayments refunded to them. If they select the refund option, Lloyds Bank PLC trading as Scottish Widows Bank should add simple annual interest of 8% running from the date of overpayment to the date of refund. It may deduct income tax from the 8% interest element (if applicable) but should give Mr and Mrs G a tax certificate so they can reclaim the tax from HMRC if they are entitled to do so.

- pay Mr and Mrs G the sum of £50 previously offered (if this has not already been paid) for elements of poor service in the response to their complaint.

-pay Mr and Mrs G £200 for the distress and inconvenience caused to them by the events which are the subject of this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs G and Mr G to accept or reject my decision before 11 August 2025.
Esther Absalom-Gough
Ombudsman