

complaint

Mr D complains about a lifetime mortgage provided by National Westminster Home Loans Limited (“NatWest”). He says the interest rate on the loan is too high, and that NatWest acted unfairly in arranging the loan.

background

In 2007 NatWest offered Mr D a £50,000 lifetime mortgage - under which interest is added to the loan balance, resulting in compound interest, and the loan and interest are eventually repaid from the sale of the property. The offer said around 70% of the equity in Mr D’s property would be ‘protected’ – so it would be ring-fenced and wouldn’t have to be used to repay the loan, however large the loan balance grew. Mr D didn’t accept that offer, and around six months later NatWest gave him an amended offer for around £155,000. The amended offer, which Mr D accepted, didn’t protect any of the equity in the property.

In early 2014 Mr D complained to NatWest that the interest rate on the mortgage was too high, and that it hadn’t agreed to let him split the title on his property and sell part of it, to raise funds to repay the mortgage. NatWest didn’t uphold the complaint. It said the interest rate on Mr D’s loan was the only one available to him at the time he took out the lifetime mortgage, and couldn’t be compared to the rate on other types of mortgage. NatWest also said it wouldn’t agree to split the title of Mr D’s property because it didn’t have a process to manage that, and wasn’t willing to accept the risks involved.

Mr D then complained to us. Our adjudicator thought NatWest should pay Mr D £1,000 compensation because it had known he wanted to protect equity in his property, but hadn’t allowed him to do that. Mr D asked for an ombudsman to review his complaint. I then issued a provisional decision, on which Mr D and NatWest have commented.

my findings

I have considered all the available evidence and arguments to decide what is fair and reasonable in the circumstances of this complaint.

NatWest recommended the first mortgage offer to Mr D in a suitability letter, which recorded that he wanted to borrow £50,000 – which was around a third of the total amount NatWest was then willing to lend him under a lifetime mortgage – and that he saw the option to protect some of the equity in his property as “*a particularly valuable benefit which suited [his] requirements*”. Soon after, NatWest issued a key facts illustration for a slightly higher loan value of £60,000. That illustration included an example of how compound interest would substantially increase the loan balance over time.

The amended offer that NatWest made around six months later was for the maximum amount it was willing to lend. The copy of the amended offer I have seen doesn’t show how compound interest would increase the loan balance over time. NatWest has not been able to produce evidence of what recommendation or advice it gave Mr D about the amended offer, but its records say it checked he was “happy” with the loan value before it issued the offer.

Sadly Mr D’s wife had died a few months before he received the first mortgage offer. Mr D was greatly affected by his wife’s death, and says he felt at that time that he himself was unlikely to live much longer. He says that with the encouragement of NatWest he decided to

borrow more than he first planned, and has given some of the extra funds to his children. But he is now concerned at how the loan balance is increasing, and wants to repay the loan.

I found provisionally that on the balance of probabilities, NatWest didn't adequately explain to Mr D how the loan balance under the amended offer would increase because of compound interest. It *had* illustrated that in the first offer - but the amended offer was for a loan three times larger, so the effect of compounding interest would be greater. I also found that NatWest most likely didn't spell out to Mr D the implications of no longer having equity protection in this context. NatWest hasn't disputed these provisional findings.

I found provisionally that NatWest should take steps to put things right for Mr D, but that the £1,000 compensation payment our adjudicator had proposed wasn't the best way of doing that. I thought it would be more appropriate for NatWest to allow Mr D a breathing space to raise funds to repay the mortgage, if he can arrange to do so – and to reinstate some protection for the equity in his property, if he can't.

I put forward proposals for doing that in my provisional decision, and both Mr D and NatWest have commented on them. Having considered their comments, I have discussed amended proposals with both parties. In what follows I summarise my initial proposals and the parties' reactions, and then set out my final conclusions.

provisional proposals on redress

Mr D had wanted to split the title to his property so he could sell part of it to repay the loan. NatWest told us it didn't agree to that because it had concerns about commercial aspects of the plan. I found provisionally that in the circumstances, it wouldn't be appropriate to order NatWest to consent to the title being split – and I noted that Mr D is now exploring other ways of raising the money to repay the mortgage. So I proposed provisionally that:

- NatWest should rework the loan account as though simple rather than compound interest had been charged since 24 February 2014, the date of NatWest's final response to Mr D's complaint (I proposed that starting point because I found provisionally that by then, NatWest should have realised that it hadn't given Mr D adequate advice at the outset, and should have taken steps to put things right);
- NatWest should continue to charge simple rather than compound interest until six months after the date of my final decision on this complaint, to allow Mr D time to raise funds to repay the mortgage without interest being compounded further; and
- if the loan isn't repaid by that point, NatWest should again be able to charge compound interest under the terms of the mortgage.

If Mr D repays the loan before late 2017, he will also have to pay an early repayment charge (ERC). This will be just over £8,000 if the loan is repaid before late 2015, and just over £6,000 if it is repaid between late 2015 and late 2017. Since I found that Mr D now wants to repay the loan because he wasn't properly advised how fast the loan balance would increase, I proposed provisionally that if Mr D repays the loan at a time when an ERC is payable, NatWest should charge only 50% of the contractual ERC.

However, I noted that Mr D may not in fact be able to raise the funds to repay the loan early. I found provisionally that in that event, it would be fair for NatWest to reinstate some equity protection for his property, but at a substantially lower level than in the first mortgage offer (which protected around 70% of the equity, on the basis that Mr D would be borrowing around 30% of what NatWest was then willing to lend). That is because Mr D has had the

benefit of borrowing the full amount NatWest was willing to lend. I proposed provisionally that 25% of the property's equity should be protected if the loan isn't repaid early.

But I noted that the financial implications of that wouldn't be clear until the loan is repaid. If Mr D repays the mortgage early, the equity protection will be irrelevant. If he doesn't, then the value of the equity protection will depend on (i) the value of Mr D's property when the loan is repaid, and (ii) the loan balance at that time. It was possible that the value of the equity protection, taken together with the other redress, would be more than £150,000 – which is the maximum redress our rules allow me to order. So I asked NatWest to let me know if it was willing to provide equity protection in excess of that amount.

Finally, I was satisfied that Mr D has experienced material distress because of the way the mortgage was arranged, and I found provisionally that NatWest should pay him £500 in compensation for that.

the parties' comments on the proposals

In response to my provisional decision, NatWest agreed to charge simple rather than compound interest for the period I had suggested, to charge only 50% of the contractual ERC if the loan is repaid early, and to pay £500 compensation. But NatWest didn't think it would be fair to reinstate equity protection at the level I had proposed. It said that would effectively give Mr D the benefit of the money he has borrowed twice – first through the proceeds of the loan, and then by preserving equity in his property which would otherwise be used to repay the loan.

Mr D said he felt strongly that the interest on his loan should have been simple rather than compound from the beginning. He also said he thought the proposed £500 compensation payment didn't reflect the stress the loan has caused him.

revised proposals for redress

I have considered the parties' comments carefully. I realise Mr D is very concerned about the interest he is being charged. I note that in principle it's reasonable for the provider of a lifetime mortgage to charge compound interest, because the borrower doesn't have to make interest payments during the term of the loan. However, it is important in such cases that the borrower understands from the outset what effect the compounding interest will have on the loan balance - and as I have found, NatWest didn't explain that properly to Mr D in this case. In these circumstances, I find there are good arguments that NatWest should provide a more generous interest concession than I proposed in my provisional decision.

Conversely, I accept NatWest's point that my proposed redress means Mr D would benefit both from the original lending, and from a level of equity protection that wouldn't have been available to him when that lending was made. The approach of this service to redress is, as far as possible, to put the consumer in the position they would have been in if things had gone right. In this case, I find that if Mr D had been properly advised, he would most likely have borrowed less and would therefore have been able to protect some of the equity in his property. However, he has had the benefit of borrowing the maximum amount that NatWest was willing to lend him at the time, and I have borne that in mind in my final conclusions on redress.

As I have said, Mr D is currently exploring options to raise the money to repay the loan early. In view of that and of the parties' responses to my provisional decision, I now find that it

would be appropriate in all the circumstances for NatWest to provide a more generous interest concession than I first proposed, but a lower level of equity protection. After discussing this further with Mr D and NatWest, I concluded that the appropriate redress in this case is for NatWest to:

- charge simple rather than compound interest on the loan, at the reduced rate of 3.39% rather than the contractual rate of 6.79%, for the period between 1 February 2014 and 31 August 2015. This is intended to give Mr D more peace of mind while he pursues arrangements to raise the money to repay the loan.
- reinstate equity protection for 12.5% of the eventual value of Mr D's property in the event that the loan isn't repaid early. This protection will only be relevant if Mr D is unable to repay the loan early. It is possible (although less likely than under my provisional proposal) that the total value of this and the other redress I am ordering may be higher than the £150,000 limit on the redress this service can order. In that case, it will be for NatWest to decide whether to provide protection above that value.
- charge Mr D only 50% of the contractual ERC if he repays the loan during a period when an ERC applies.
- pay Mr D £1,000 in compensation for distress and inconvenience. This is more than my provisional proposal, and reflects the substantial upset that I'm satisfied Mr D has experienced because of the loan.

In response Mr D suggested the interest concession should apply for a longer period than I had proposed. He thought it would be fair to rework the loan account as though simple interest at the lower rate had been due for the last four years.

I have considered Mr D's suggestion carefully. Having done so, I find that the fair outcome in this respect is for the interest rate concession to begin in February 2014, as I proposed. That was the point at which NatWest considered Mr D's concerns about the mortgage and could have done something to address them. In my view, any substantial extension of this interest rate concession - which already offers a significant saving compared with the contractual rate - wouldn't fully reflect the benefit that Mr D has had from the loan.

I now invite Mr D to consider whether to accept my final decision.

my final decision

For the reasons I have given, my final decision is to uphold this complaint. I order National Westminster Home Loans Limited to:

- charge simple rather than compound interest on the loan, at the reduced rate of 3.39% rather than the contractual rate of 6.79%, for the period between 1 February 2014 and 31 August 2015;
- reinstate equity protection for 12.5% of the eventual value of Mr D's property in the event that the loan isn't repaid early;
- charge Mr D only 50% of the contractual ERC if he repays the loan during a period when an ERC applies; and
- pay Mr D £1,000 in compensation for the distress he has experienced.

Under the rules of the Financial Ombudsman Service, I am required to ask Mr D to accept or reject my decision before 9 March 2015.

Tony Stafford
ombudsman