

## **The complaint**

Mr C has complained about the early repayment charge (“ERC”) he incurred when he repaid his buy to let (“BTL”) mortgage with Santander UK Plc. He said the amount charged is financial exploitation and profiteering at its dirtiest and flies in the face of the regulator’s guidance.

## **What happened**

Mr C had an existing BTL mortgage with Santander, and in 2021 he applied online to move it onto a new preferential interest rate. The mortgage offer dated 2 August 2021 indicated the outstanding balance was around £221,000, it had a term of 16 years and 6 months, and the mortgage was held on an interest only basis. The rate was fixed at 1.69% until 2 November 2023, with an ERC being due if the mortgage was repaid before that date. That gave a contractual payment of around £310 a month.

In 2022 Mr C complained to Santander about the ERC. Santander didn’t uphold the complaint and so Mr C referred the matter to us.

In the meantime Mr C made lump sum payments of around £22,100 in December 2022 and £19,900 in January 2023 (without incurring any ERCs), and then he redeemed the remaining mortgage of around £179,000 when he sold the property for £465,000 in January 2023 incurring an ERC of around £5,400.

One of our Investigators looked at the complaint and didn’t uphold it.

Mr C didn’t agree, and as an agreement couldn’t be reached the case was passed to me to decide.

## **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.

Although I’ve read and considered the whole file, I’ll keep my comments to what I think is relevant. If I don’t comment on any specific point it’s not because I’ve not considered it but because I don’t think I need to comment on it in order to reach the right outcome. This service is impartial between, and independent from, consumers and businesses. What this means is that we don’t represent either party, and I don’t act under either’s instructions or take directions on how a complaint will be looked at.

In resolving complaints, we determine what’s fair and reasonable in the individual circumstances of the case – taking into account relevant law and regulations, as well as regulatory rules and guidance and good industry practice.

Mr C has made specific reference to the ‘reasonableness test’ in the Unfair Contract Terms Act 1977. That says, under point 1:

*“In relation to a contract term, the requirement of reasonableness for the purposes of this*

*Part of this Act, section 3 of the Misrepresentation Act 1967 and section 3 of the Misrepresentation Act (Northern Ireland) 1967 is that the term shall have been a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made."*

The key part of that is "*having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties **when the contract was made.***" [my emphasis]

Santander set the ERC when the contract was made, so anything that happened after that - such as the exact point Mr C chose to redeem his mortgage and why, and the level of interest rates at that time - wasn't known (or ought reasonably to have been known) when the contract was made.

Although I take relevant law into account, specific findings of a breach of the Unfair Contract Terms Act 1977 are more a matter for the courts than they are for me. I think the crucial question is whether Santander acted fairly when it set the ERC at the level it did and then required Mr C to pay that sum when he repaid his BTL mortgage.

Mr C has also quoted from PRIN 2.1 'The Principles' from the Financial Conduct Authority's handbook. The screen shot Mr C has provided isn't the Principles as they stood at the time in question as Mr C took out this rate in 2021 and redeemed the mortgage in January 2023, but the screen shot Mr C provided is from the Principles following them being updated in July 2023. PRIN 1 and PRIN 6 were in place at the time in question, but PRIN 12 didn't exist until July 2023 and so I can't take that one into account.

Whilst I won't mention PRIN 1 and 6 specifically in the remainder of this decision I can reassure Mr C that they are always something I keep in mind when deciding complaints like his as they are the underlying Principles at the heart of what we do – that is, decide what is fair and reasonable in the circumstances of a complaint.

Mr C has said he was vulnerable, given he had no income and the property wasn't attracting the interest of potential tenants. He's said letting agents told him it wasn't the sort of property people were wanting to rent at that time, due to its location and lack of outside space.

I can confirm that is something I've taken into account when deciding this case, however I would say that whether or not the ERC was waived wouldn't have altered the fact Mr C couldn't rent the property and had no income at the time. Whilst it would have given him around £5,400 more upon the sale, it wasn't the case that the property was sold in negative equity (or there was only a small amount of equity) and it was Mr C's residential property.

It may have been that Santander would have looked at this differently if, perhaps, this was a residential house sale where the borrower could no longer afford their mortgage, and there being insufficient equity to cover the ERC once the mortgage debt was repaid, so it could be a barrier to the customer being able to sell a property they can no longer afford to live in. Santander wouldn't be expected to take the same approach for a customer deciding to sell an investment property as they were struggling to rent it out at the price they wanted.

Whilst there was obviously a financial impact on Mr W, he wasn't in the situation where this was his residential property and he was at risk of having his home repossessed or be left in negative equity due to the addition of an ERC.

We're not the regulator, and I've no power under our terms of reference to comment on, or otherwise determine, how financial businesses operate in general terms. I have to consider

this complaint by reference to Mr C's particular situation. When I do that, I'm satisfied the terms of the ERC were set out in the mortgage offer in a way that should have been readily understandable to Mr C; certainly, the information about the ERC was set out in a manner that met the regulator's requirements. So I'm persuaded Mr C knew – or at least should have known – how much he'd have to pay if he repaid the mortgage before 2 November 2023.

That said, I need to decide what is fair and reasonable in the individual circumstances of the complaint. The rules we operate under say that in doing that I must take into account, amongst other things, the relevant rules and regulations. The relevant rules for residential mortgages are set out in the Financial Conduct Authority's Mortgages and Home Finance: Conduct of Business sourcebook (MCOB). As this was a BTL mortgage it wasn't subject to those rules and guidance, however they are a good indication of what is good industry practice for ERCs so I will make reference to those rules and guidance here.

MCOB includes 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. But a lender can choose how it calculates an ERC and can calculate the same level of ERC across a group of mortgages of similar type, rather than for individual loans. Santander is entitled to set an ERC based not on the actual cost to it of Mr C ending his own mortgage early, but on a reasonable pre-estimate of the costs of early termination of a group of mortgages of similar type.

Lenders generally raise money to offer preferential rates for their mortgage customers on the wholesale money markets. There's a cost to that, and it's generally fixed in advance. But the lender expects to receive a return to outweigh those costs. If a mortgage ends early, it doesn't get back all the returns it expected, and so doesn't make back the costs in raising the funds to offer that preferential rate.

It's complex and onerous for lenders to calculate individual losses as and when individual customers decide to terminate their contracts early. And it isn't possible to estimate, for any given individual, when or if they might do so. So Santander is allowed to project how many customers, on average, are likely to terminate early and, on average, at what point they're likely to do so, and to apportion that cost across the mortgages in the group. For some individual mortgages that will end up being an over-calculation, and for others it will be an under-calculation. But that's allowed; Santander doesn't have to refund the difference, but equally it doesn't tell a consumer to pay the difference if it goes the other way.

The ERC is expressed as a cash value in the mortgage offer. So I've considered whether the ERC was a reasonable pre-estimate of the cost of the mortgage being repaid early.

Santander has provided us with evidence to show how it pre-estimated the costs of this group of mortgages being repaid early. Under our rules I am allowed to accept evidence in confidence if it is appropriate to do so. I am satisfied that the information Santander has provided is commercially sensitive and I have good reason to accept that in confidence and so I won't be disclosing it to Mr C.

The information from Santander shows that it takes into account a number of factors when estimating the cost of a fixed rate mortgage being repaid. It has provided a breakdown of the figures it used and an explanation for the calculations and estimates it has made. It shows that the ERC reflects its costs of setting up and servicing the mortgage, the cost of the capital it has to set aside, the cost of funding the fixed rate, the cost of financial instruments that could be used to protect its position (and unwinding those) and its future losses. I've looked carefully at what Santander has said and I consider it is a fair way to calculate the ERC.

I appreciate that Mr C was getting near to the end of the tie-in period (redeeming the mortgage around ten months before it was due to end) and that the amount of the ERC appears out of proportion to the number of payments that were remaining under the fixed rate. But I'm afraid that isn't a factor in how the ERC is calculated, nor is the actual cost to Santander of this individual mortgage being repaid at the exact time it was.

MCOB only requires Santander to make a reasonable pre-estimate of the cost to it of the mortgage being repaid early across a range of similar mortgages. I consider that is what it has done. And based on the information presented to me I consider it was reasonable for it to charge the ERC it did.

I've sympathy for the position Mr C found himself in, but his situation wasn't unusual. Many customers have to sell their properties (albeit for other equally valid reasons) and incur an ERC when doing so. It would be highly unfair for Santander to treat Mr C any differently from how it would treat any other customer that sold their property whilst in an ERC tie-in period.

There was no reason for Santander to reduce – or waive – the ERC because it hadn't done anything wrong. I can only uphold a complaint and order compensation if a business has done something wrong. As I'm satisfied Santander did nothing wrong then there are no grounds for me to order it to refund the ERC, either in full or in part.

Mr C has said that Santander could now re-lend his mortgage amount out at a higher rate, so he thinks Santander wouldn't make a loss. But Santander couldn't have known, in 2021, that Mr C would choose to end his mortgage early, when he would choose to do so, and that interest rates would be at the level they are now at the point Mr C chose to end the mortgage. Equally, things could have gone a different way, with Mr C choosing to end his mortgage at a point preferential interest rates were lower than when he took out his mortgage, and so any new mortgage lending Santander granted would be at a lower rate than Mr C was paying. In that instance Santander wouldn't make Mr C pay more to cover any additional potential losses, and equally Santander isn't expected to refund any difference if it goes the other way.

As I said above, in some instances the ERC will be "too much" and in others it will be "too little". That is allowed under the rules as long as, at the point it was set, the ERC was a reasonable pre-estimate of the potential loss the lender would incur upon early repayment in line with the regulatory guidance in MCOB. Here I'm satisfied it was.

Having considered everything, I'm satisfied:

- Santander was entitled to charge Mr C the ERC set out in his mortgage contract when he repaid his mortgage early.
- There was no requirement for Santander to only charge an amount worked out based on Mr C's individual loan and date of redemption, instead it was allowed to charge an amount based on its pre-estimate of the costs of early termination of a group of mortgages of similar type.
- Santander didn't have to treat Mr C any differently to any of its other customers that redeemed their mortgage whilst there is an ERC in force.
- Santander didn't have to waive the ERC either in full or in part.

For all the reasons given I don't think Santander acted unfairly or unreasonably in this matter.

**My final decision**

I don't uphold this complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr C to accept or reject my decision before 21 December 2023.

Julia Meadows  
**Ombudsman**