

The complaint

Mr and Mrs W have complained about the early repayment charge (“ERC”) they’ll incur if they redeem their mortgage with TSB Bank plc.

They’re thinking about moving home and are unhappy that, unless they keep their mortgage with TSB and port it to their new property, they’ll incur an ERC of around £2,600. They say they were told when they took out the mortgage that the ERC was to recompense the bank for any unrecoverable interest costs if they ended the rate early.

They’d like TSB to either waive the ERC, or to match the current best in market five-year fixed rate mortgage for the whole mortgage amount.

What happened

Mr and Mrs W took out this mortgage in 2019. The mortgage offer dated 18 October 2019 indicated they were borrowing around £143,000 (including fees) over a 26-year term on a repayment basis. The rate is fixed at 1.94% until 30 November 2024, with an ERC being due if the mortgage is repaid before that date.

In January 2023 Mr and Mrs W complained to TSB about the ERC. TSB didn’t uphold the complaint and so Mr and Mrs W referred the matter to us.

One of our Investigators looked at the complaint. He said TSB had evidenced to us how it had set the ERC in line with the regulator’s guidance and, having considered all the information provided, he was satisfied TSB hadn’t done anything wrong. For that reason he said he wouldn’t be asking TSB to either waive the ERC or to offer Mr and Mrs W a different rate than it offered to all its other customers.

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.

Mr and Mrs W have referred to the ERC as a penalty. The ERC isn’t a “penalty” as that has a distinct meaning in law; it’s a contractual term that applies where there is a breach of contract. But if Mr and Mrs W repay their mortgage within the ERC period, there is no breach of contract. That’s because the contract allows for the mortgage to be repaid if they pay 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 and Mrs W’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 and Mrs W; certainly, the information about the ERC was set out in a manner that met the regulator’s requirements. So I’m persuaded Mr and Mrs W

knew – or at least should have known – how much they'd have to pay if they repaid the mortgage before 30 November 2024.

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. In this case that is the Financial Conduct Authority's Mortgages and Home Finance: Conduct of Business sourcebook (MCOB).

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. TSB is entitled to set an ERC based not on the actual cost to it of Mr and Mrs W ending their 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 TSB 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; TSB 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.

TSB 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 TSB 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 and Mrs W.

The information from TSB 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 TSB has said and I consider it is a fair way to calculate the ERC.

Mr and Mrs W have said they were told by the adviser when they took out the mortgage that the ERC was to recompense the bank for any unrecoverable interest costs if they ended the rate early. Which, in broad terms, is correct. But as I've explained above, the ERC isn't set based on the unrecoverable interest costs for each mortgage in isolation as that wouldn't be possible to know in advance and the ERC must be known in advance as it must be shown in the mortgage offer. It also takes into account other unrecoverable costs.

Even if I did think that the adviser misled Mr and Mrs W in 2019 that would be what we call a misrepresentation; that is, TSB gave incorrect information to Mr and Mrs W about the background to the ERC calculation and how it is set.

When we're looking at complaints about misrepresentations, we consider the appropriate remedy is to place the consumer in the position they would be in if the incorrect information hadn't been given. We don't put them in the position they would be in if the misinformation had been correct (that is, Mr and Mrs W could pay a different ERC).

Mr and Mrs W could never have been in the position where their ERC would be calculated differently to how it was set out in their mortgage offer. I don't think they would have done anything different in 2019 had the adviser explained things differently because, by the time the mortgage completed, they'd been issued with the binding mortgage offer which set out the terms of the contract they were entering into (including the potential ERC if they ended the mortgage early). If they felt that didn't represent how they thought the ERC would work then they could have chosen not to proceed with the mortgage offer from TSB. Instead they accepted the mortgage offer and, when the mortgage completed, they then became bound by those terms, including the ERC clause.

Mr and Mrs W have said that TSB could now re-lend their mortgage amount out at a higher rate, so they think TSB wouldn't make a loss. But TSB couldn't have known, in 2019, that Mr and Mrs W would choose to end their mortgage early, when they would choose to do so, and that interest rates would be at the level they are now at the point Mr and Mrs W chose to end the mortgage. Equally, things could have gone a different way, with Mr and Mrs W choosing to end their mortgage at a point interest rates were lower than when they took out their mortgage, and so any new mortgage lending TSB granted would be at a lower rate than Mr and Mrs W were paying. In that instance TSB wouldn't make Mr and Mrs W pay more to cover any additional potential losses, and equally TSB 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:

- TSB is entitled to charge Mr and Mrs W the ERC set out in their mortgage contract if they repay their mortgage early.
- There is no requirement for TSB to only charge an amount worked out based on Mr and Mrs W's individual loan and date of redemption, instead it is allowed to charge an amount based on its pre-estimate of the costs of early termination of a group of mortgages of similar type.
- TSB doesn't have to treat Mr and Mrs W any differently to any of its other customers that redeem their mortgage whilst there is an ERC in force.
- TSB doesn't have to offer a bespoke new interest rate product to Mr and Mrs W, nor does it have to waive the ERC.

For all the reasons given I don't think TSB 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 and Mrs W to accept or reject my decision before 30 October 2023.

Julia Meadows
Ombudsman