DRN-4197145

## The complaint

Mr and Mrs S complain that Lloyds Bank PLC trading as Scottish Widows Bank wouldn't allow them to port their interest only offset mortgage to a new property. As a result they incurred an early repayment charge (ERC).

## What happened

Mr and Mrs S took out their offset mortgage with Scottish Widows in 2019. They borrowed just under £400,000 on interest only terms over nine years. The interest rate was fixed at 1.99% for the first five years of the term, until May 2024. During that period they would have to pay an ERC if the mortgage was repaid – the amount of the ERC reduced year by year. At the time of the events of this complaint it was 2.35% of the mortgage balance.

In 2022 Mr and Mrs S decided to move to another property and asked their mortgage adviser to arrange to port their mortgage to the new property. By this time they were retired but had a comfortable income from pensions and investments. The adviser applied to Scottish Widows on their behalf.

At first Mr and Mrs S applied to extend the term of the mortgage to 16 years – an extension of around 10 years. Scottish Widows refused the application. It said that it required a minimum income of £100,000 for a new interest only mortgage and Mr and Mrs S didn't meet that threshold. It didn't think Mr and Mrs S had an acceptable repayment strategy for their interest only mortgage.

Mr and Mrs S then re-applied, this time for the same term as their existing mortgage, but Scottish Widows still refused their application. It also said that converting to repayment terms (which Mr and Mrs S didn't want to do anyway) wouldn't be affordable.

Because Scottish Widows wouldn't allow Mr and Mrs S to port their mortgage to the new property they repaid it, incurring an ERC of around £9,500. They didn't re-mortgage; they completed their new purchase as cash buyers. Mr and Mrs S then complained.

Scottish Widows didn't uphold their complaint about the decision to refuse to allow them to port, but it offered £50 compensation for delays in updating their broker. Mr and Mrs S didn't accept that and brought their complaint to us. Our investigator didn't think Scottish Widows had acted fairly and said it should refund the ERC and pay them £150 compensation. Scottish Widows didn't agree and asked for an ombudsman to review their complaint.

## 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.

Having done so, I'm not persuaded Scottish Widows acted fairly in this case. I'll explain why.

Following changes to the rules of mortgage regulation in 2014, lenders are required to carry out strict assessments of both affordability and – in the case of interest only lending – of repayment strategy.

There are, however, some exceptions to those requirements. The rules of mortgage regulation can be found in the Financial Conduct Authority Handbook, in the chapter headed MCOB.

- MCOB 11.6.3 says that a firm doesn't need to assess affordability when entering into a new mortgage that replaces an old one, or when varying an existing mortgage – provided that there are no changes being made which are material to affordability.

- MCOB 11.7.3 says that a firm doesn't need to assess interest only repayment strategy – provided that the original mortgage was taken out before 26 April 2014 (that is, under the old rules), provided it hasn't increased in balance since then and isn't increasing now, and provided the transaction would otherwise be in the borrowers' best interests.

Mr and Mrs S's first application was to port their mortgage over to their new property – with the same borrowing but an extended term, increasing from six to sixteen years.

At the time of the application Mr and Mrs S were already retired, so extending the term means that it would extend further into their retirement than it already did. I've referred above to MCOB 11.6.3, which says that a firm doesn't need to assess affordability when entering into a new mortgage that replaces an old one, or when varying an existing mortgage – provided that there are no changes being made which are material to affordability. Extending the term of a mortgage into, or further into, retirement is one of the things the rules say will be material to affordability.

What this means is that under the rules Scottish Widows had to assess affordability. Based on Mr and Mrs S's income at the time, I don't think it was unreasonable that Scottish Widows refused this application.

Following the refusal, Mr and Mrs S's broker submitted a second application. This time the mortgage term was to remain at six years – so the new mortgage would be exactly the same as their current one. As the term would no longer be extended, there was no change material to affordability, and so MCOB 11.6.3 applied to this application – with no need for Scottish Widows to assess affordability.

However, Scottish Widows did refuse this application as well. It said Mr and Mrs S didn't have an acceptable repayment strategy for their interest only mortgage.

I've said that under the mortgage rules lenders have to assess whether there's a suitable repayment strategy. As Mr and Mrs S would be replacing a mortgage taken out in 2019 – after 26 April 2014 – MCOB 11.7.3 didn't apply and so Scottish Widows was required to carry out an assessment of their strategy.

I don't therefore think it was unfair that Scottish Widows considered this. Under the mortgage rules, it had to do so. However, I don't think the decision it reached – having considered their repayment strategy – was fair and reasonable in all the circumstances.

Mr and Mrs S's mortgage is an offset mortgage. At the time of their application to port, virtually the whole balance was offset by savings in the linked account.

However, Mr and Mrs S's property sale and purchase wasn't simultaneous. They were buying their new property, and then would be selling the old one a little while later. In order to do this they planned to use the cash savings in their offset account plus the new ported mortgage – this would allow them to pay off the mortgage on their old property and fund the purchase of the new one.

At the time of the application, Mr and Mrs S had sufficient in cash and other investments to be able to repay their interest only mortgage. At the time of completion they wouldn't have the cash, but they would have a second, mortgage-free, property. And shortly after completion, having sold that property, they would have the cash in their offset account again.

Scottish Widows wouldn't accept this as a repayment strategy. It said its lending criteria for interest only mortgages require a minimum amount of employed or self-employed income where customers are relying on cash savings or a second property. As Mr and Mrs S were retired, they did not have any income of this type and didn't meet this requirement.

I don't think this was fair. These are the lending criteria Scottish Widows applies to new customers. Mr and Mrs S weren't new customers. They were existing customers looking to replace their existing mortgage with one that was exactly the same, with the same repayment strategy and therefore the same level of risk to Scottish Widows.

The rules of mortgage regulation require a lender to assess whether a borrower has a credible and clearly understood repayment strategy. They don't require a particular income level. While it's not unreasonable for Scottish Widows to have a higher threshold than required by the rules for new lending, the effect of applying its new customer criteria to Mr and Mrs S as existing customers was that they would not be able to port their mortgage and would have to pay an ERC. I don't think that was fair.

Mr and Mrs S were existing customers of Scottish Widows. They were looking to replicate their existing mortgage, but secured over a new property. Their repayment strategy was unchanged, and was credible and clearly understood. I think Scottish Widows ought to have thought more broadly about their situation and recognised that they were not making any changes to their mortgage, that they did have a way of repaying the capital, and that a strict application of its new borrower criteria to Mr and Mrs S (who were not new borrowers) would result in Mr and Mrs S having to pay a substantial ERC.

But allowing them to port would not increase the risk that either Mr and Mrs S or Scottish Widows were exposed to, and would essentially just replicate the existing situation but with a new property. I don't think refusing their application was fair and reasonable in all the circumstances. I think Scottish Widows ought fairly to have allowed Mr and Mrs S to port their existing mortgage on a like for like basis, as their second application proposed.

**Putting things right**

If Scottish Widows had allowed Mr and Mrs S to port their mortgage, they wouldn't have paid the ERC. In the circumstances, I think it would be fair and reasonable for Scottish Widows to refund the ERC, adding interest to compensate Mr and Mrs S for being without the funds in the meantime.

I understand Mr and Mrs S ended up buying the new property outright, so they've not ended up with a different mortgage at a better or worse interest rate which needs to be factored into the redress. And while Mr and Mrs C will benefit by not having a mortgage in future, they've also now lost access to the money used for the purchase which was previously in the offset account. Having that money in the offset account meant they paid very little interest in practice. Their priority was to avoid repaying the ERC. Because Scottish Widows didn't consider their application fairly they ended up having to pay it. While they've ended up mortgage free as a result, that wasn't how they wanted to manage their finances and I don't think it's a reason to reduce the ERC refund.

Finally, Scottish Widows should also compensate them for the distress and inconvenience caused. Our investigator suggested compensation of £150 which Mr and Mrs S accepted. I think that's fair.

**My final decision**

My final decision is that I uphold this complaint and direct Lloyds Bank PLC trading as Scottish Widows Bank to:

- Refund the early repayment charge Mr and Mrs S paid on redemption of their mortgage, adding simple annual interest of 8% running from the date of redemption to the date of refund; and

- Pay Mr and Mrs S £150 compensation.

Lloyds Bank PLC trading as Scottish Widows Bank may deduct income tax from the 8% interest element of my award, as required by HMRC. But it should tell Mr and Mrs S what it has deducted so they can reclaim the tax if they're entitled to do so.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr S and Mrs S to accept or reject my decision before 11 January 2024.

Simon Pugh
**Ombudsman**