

The complaint

Mr S and Mr W are unhappy with the way that National Westminster Bank Plc have handled their mortgage application due to the way their income has been assessed.

What happened

Mr S and Mr W applied for a mortgage with NatWest in June 2021 via a broker. A valuation was conducted on the property in June 2021 and the property was deemed to be suitable security for a mortgage. The property valuation was £275,000.

A mortgage offer was issued by NatWest for £190,875 which incorporated a £995 product fee which was added to the loan of £189,880. This was the maximum amount that NatWest were prepared to offer Mr S and Mr W. The mortgage completed on 29 June 2021 at a loan to value (LTV) of just under 70%.

Mr S and Mr W feel that they have been treated unfairly because NatWest uses a multiple of a customer's gross income which is capped at 4.9 times their income. And because NatWest's system assumes tax and national insurance deductions, the system assumed that Mr W's net income was lower than his gross income.

Mr W's income comes from a military disablement pension from an overseas government, so it is tax exempt. Mr W says that means his net income is higher than that of someone with the same gross income who must pay tax and National Insurance (NI) contributions. But NatWest didn't take this into account when assessing his income.

Mr S and Mr W say that because of NatWest's policy regarding income multiples, and because its system underestimated his net income, they were not able to borrow as much as they thought they could have when they took the mortgage out. And because of this, they had to borrow £65,000 in personal loans which were all at much higher interest rates to complete the home improvements they had planned to do on their property.

Mr S and Mr W explained that they were originally looking at two different options:

1. A mortgage with 85% LTV which would have given them a mortgage of £233,750 fixed at 2.03% for five years with a monthly repayment of £1,060.67 – overall mortgage term 24 years
2. A mortgage with 90% LTV which would have given them a mortgage of £247,500 fixed at 2.53% for five years with a monthly repayment of £1,147.40 – overall mortgage term 24 years

To put things right, Mr S and Mr W would like NatWest to change their lending criteria to enable tax-exempt income in their calculations and allow them to borrow what they believe they should have been allowed to borrow at the time.

Mr S and Mr W complained to NatWest who said they cannot assess Mr W's income in a different way than their systems allow. Therefore, all customers are assessed in the same way and treated equally. NatWest said they are a UK based bank therefore subject to UK tax laws.

Mr S and Mr W didn't agree with this, so they brought their complaint to the Financial Ombudsman Service where it was looked at by one of our investigators. The investigator didn't find evidence that NatWest's policy regarding the income multiples fell short of the

FCA guidelines. But she didn't think that NatWest acted fairly by deducting tax and NI contributions from Mr W's gross income even though he didn't pay them. She thought that NatWest should pay Mr S and Mr W £250 for the inconvenience they were caused. But she didn't think that NatWest should re-assess Mr S and Mr W's mortgage application as she felt that due to the increase in their outgoings (because of the personal loans) – the new loan wouldn't be affordable.

Mr S and Mr W disagreed with what the investigator said. They made detailed comments as to the reasons they still felt it was unfair. I have included some of their comments below:

- They don't understand how two individuals with the same disposable net incomes, same risk profiles can be offered two different amounts. This would break all fairness rules and constitute discrimination and breach the FCAs' principle 6 – treating customers fairly.
- They disagree that there is no evidence to suggest that NatWest's interpretation of income multiples guidance falls short of the FCA regulations. Any in-house policy on income multipliers must take into account MCOB 11.6.5 R (2) (a) that sets out how income is calculated for affordability.
- NatWest used a stress test which is significantly higher than the interest rate they are on. The Bank of England states a 3% stress loading on the reversionary rate so should have resulted in a stress test of 6.59% and not 7.25%.
- If they were permitted to borrow the higher amount (the same as someone with the same means who pays tax) of £231,400 over five years, the stress test would not have been applicable and would have made the mortgage more affordable.
- MCOB 11.6.7 G permits lenders to impose limits on how much a customer can borrow in the form of a multiple of their gross income. This is guidance and not a rule. It states 'such an approach is not, of itself, inconsistent with MCOB 11.6.2 R but in accordance with the *rules* in this section, the firm must be able to demonstrate that the loan is affordable, having taken full account of the *customer's* income and expenditure'. If NatWest's in-house policy infers multipliers are a Rule, then there is a fault in their policy and needs to be corrected.
- They have an email from a manager at NatWest who confirmed that every customer has tax and NI deducted and no provision is made for those with tax exemptions. This goes against treating customers fairly. NatWest are using a blanket approach and discriminating against all people with tax-exempt income.
- They would like their mortgage to be restructured based on what they could borrow. Their income has now increased, and the value of their property has also increased after the work they have carried out. Based on their income and the income multiplier, they would be given a higher mortgage.

Mr S and Mr W have given a detailed example of how they would like things to be put right. Which in summary, means they save £255 per month based on what they have worked out the difference to be if NatWest should restructure the mortgage now, based on their income and valuation as it stands today and believe this would pass the affordability test.

As Mr S and Mr W disagreed with our investigator's assessment of their complaint, they asked for the complaint to be reviewed by an ombudsman, so it has been 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.

I take into account the law and regulations, the regulator's rules guidance and standards, and what I consider to be good industry practice at the time.

I've taken into consideration everything that Mr S and Mr W have said, and I know they feel very strongly about their complaint. They have provided detailed comments in support of their views which I can confirm I've read and understood in their entirety. However, I trust that Mr S and Mr W will not take the fact that my findings focus on what I consider to be the central issues, and that they are expressed in considerably less detail, as a discourtesy. The purpose of my decision isn't to address every point raised. The purpose of my decision is to set out my conclusions and reasons for reaching them.

This complaint has been investigated thoroughly and I have previously issued two provisional decisions on this case before reaching my final decision.

Mr S and Mr W applied for a mortgage via a broker in June 2021 and I have been provided with a significant amount of information to determine this complaint. What this has now come down to, is to what extent NatWest were aware of Mr W's income being exempt from UK tax at the time it assessed their mortgage application.

There have been various documents that Mr S and Mr W have provided us which shows Mr W's pension income is paid gross – without the deduction of tax. I've taken a look at the pension letter dated 10 January 2020 that was provided to NatWest confirming Mr W's Australian pension. This letter confirms that the pension is paid gross, but it does not say that the pension is not subject to UK tax or NI. It does not confirm that Mr W would not have to declare the income and pay tax via self-assessment, for example.

The letter dated 24 February 2016 from HM Revenue and Customs to Mr W confirms that the pension he gets from Australia is exempt from UK tax as they are disability pensions and the employments ceased due to disablement. This letter is clear evidence that Mr W's pension is exempt from UK tax. But it's now been established that this wasn't provided to NatWest as part of the mortgage application.

NatWest have said that there was no indication or notes from the broker on the application that the Australian pension was not subject to UK tax or NI and this wasn't highlighted in any other correspondence with the broker – which confirms what the broker has said, in that no specifics about Mr W's income were sent to NatWest.

NatWest said they can see from the bank statements that payments are paid gross into the account but nothing to suggest Mr W doesn't have to pay UK tax on foreign income so as far as they were aware, they didn't know. The bank statements show gross income credits as the same as what has been declared – showing no tax deducted.

I'm therefore satisfied that NatWest knew that Mr W's pension was paid to him and received into his bank account gross of tax – so tax had not been deducted at source. But it hadn't specifically been told that Mr W was not liable to pay tax at all on this income, for example by self-assessment. So the question here is whether there was an expectation on NatWest to question this further. I've thought about this both as a matter of general fairness, and in the context of the fact that Mr W's situation arose from his disability.

The Equality Act is the relevant law in this respect. I've taken the Act into account – including thinking about whether NatWest had a legitimate aim, and whether it used proportionate means to achieve it.

It's reasonable – and required by the rules of mortgage regulation – to consider whether a mortgage is affordable for the applicants. I also think it's reasonable for NatWest to assume that an applicant with income above the relevant thresholds is liable for UK tax – unless it has reason to know that's not the case. I don't think it's fair to expect NatWest to make a special effort to ask whether that's true of every customer as part of its affordability

assessment, since it will be of the vast majority. Where it receives an application from a regulated mortgage adviser, I think it's reasonable for NatWest to expect the adviser to draw its attention to any unusual features it needs to take into account.

I therefore think that it was fair to expect the broker to have told NatWest that Mr W does not pay UK tax. Just because the statements and pension letter say that Mr W's income is gross – that doesn't mean that UK tax won't be paid.

The broker supplied the bank statements and the letters to NatWest which showed that the income was gross, but the HMRC letter which confirms that the pension is in fact exempt from UK tax – was not sent. Unless NatWest are told outright – there is no reason for them to know that this is the case, and this situation is sufficiently unusual that I don't think it was unreasonable that NatWest assumed that Mr W did pay tax in the absence of being told he didn't.

I accept that the broker said the application form does not differentiate between taxable and tax-free income – but I would have expected something to be sent to NatWest to explain the unique situation that Mr W found himself in so that it was made clear to NatWest that Mr W is not liable to pay UK tax.

If NatWest had known about Mr W's situation at that time, I think it would have been fair to expect it to have assessed his income on the correct basis – without deducting assumed tax. And NatWest have already said that this would have given Mr W more disposable income which would have impacted the affordability assessment. But as it didn't know that, I don't think it was unfair that it did assume he would pay tax on his income.

I also think it would have been reasonable – had it known – for NatWest to adjust the income multiplier cap so that the same overall limit was reached based on Mr W's income as it would have been if he paid tax to reach the same disposable income. This adjustment to NatWest's standard criteria ensures he wouldn't be treated less favourably than a borrower with the same disposable income but higher gross income – when the reason Mr W's gross and disposable incomes are the same is because of a matter arising from his disability. But NatWest did not know. This is something NatWest will need to take into account if Mr W makes any future applications.

Mr S and Mr W have told us that before they made an application through their broker in June 2021, they had applied directly with NatWest in April 2021. They said that the HMRC letter which confirms that Mr W is not liable for UK tax was uploaded to NatWest's system as part of that application. But that application didn't go any further because Mr S and Mr W couldn't borrow as much as they wanted. Mr S and Mr W also told us that they applied for additional borrowing with NatWest in July 2022 where they submitted the relevant HMRC letter again. But again, they couldn't borrow as much as they wanted so this application didn't proceed any further. So they believe that NatWest knew all along about Mr W's income not being liable for UK tax.

I appreciate that Mr S and Mr W have told us that they made other applications to NatWest where they have informed them of Mr W's tax status, but this complaint is only about the broker application which was made in June 2021. A complaint hasn't been made to NatWest about the direct application made in April 2021 or about the July 2022 additional borrowing request. So if Mr S and Mr W believe that NatWest knew about his tax status prior to the broker application, then they can raise a separate complaint with NatWest if they wish to do so.

For completeness to this point, I would point out that even if this was the case, NatWest would have assessed the application that Mr S and Mr W made in June 2021 and they are not expected to go back and look at any historical applications and documents that were submitted. I understand that Mr S and Mr W think this should happen – but this isn't how applications work. Each application is looked at on its own merit and underwriters would not be expected to go back and look at any historical documents or applications that were made.

I've solely focussed on the application which was made in June 2021 and the relevant letter in question that should have been sent to NatWest wasn't. So I'm satisfied that NatWest was not aware at this time of the unique nature of Mr W's income.

Mr W believes he has been discriminated against by NatWest.

I've already explained in my first provisional decision that I am satisfied that Mr W has a disability that amounts to a protected characteristic under the Equality Act. And that is the relevant law for me to take into account. The Act places obligations on NatWest to make reasonable adjustments to enable persons with a disability to access its services – such as mortgage lending – and also that treating someone differently because of a matter arising from their disability may not amount to discrimination.

I'm satisfied that NatWest, although aware that Mr W gets his income paid gross, did not know that he was not liable for UK tax. I don't think that NatWest chose to treat Mr W less favourably because of his disability; it wasn't aware that its standard approach to affordability wasn't appropriate in this case. And I don't think it would be reasonable to say that NatWest failed to make adjustments to how it carried out the affordability assessment when it had no reason to know it needed to.

However, now that it is aware, NatWest should ensure that any future applications made by Mr S and Mr W are assessed correctly, taking into account the fact that Mr W isn't liable for UK tax. I think it would be sensible for the February 2016 letter to be supplied with any further applications that are made as NatWest may want to see this.

NatWest should ensure they carry out any future affordability assessments for Mr W without the deduction of tax or NI. This would give Mr W more disposable income which will impact the affordability.

The income multiplier cap should be adjusted to make allowance for the fact that Mr W's pension is paid without tax liability because of a disability.

As a matter of prudential regulation, at the time lenders were permitted to have only a certain proportion of their overall lending at income multiples of over 4.5 and NatWest set their own maximum income multiples. And that in applying this in practice, NatWest set maximum income bands for the maximum it will lend against a customer's gross income for their own credit risk purposes. This was legitimate and reasonable for NatWest to take this approach in general, but I think that not adjusting this going forwards could result in an unfair outcome for Mr W and would put him at a disadvantage compared to other customers that do pay tax and NI.

If NatWest used the same gross income threshold for Mr W that it would use for any customer, the effect of this would mean that Mr W would need more disposable income than other customers to satisfy the same gross income threshold. And we've already established that NatWest should not deduct tax or NI for Mr W which would give him more disposable income. But if the income multiplier doesn't get adjusted for Mr W to reflect the fact he has more disposable income each month, then he is still put at a disadvantage. So I think if NatWest were to have the same gross income threshold as it does for all customers, this puts Mr W at a particular disadvantage when compared with customers who are not tax exempt by reason of a disability. So this income multiplier cap would need to be adjusted.

We cannot determine the outcome of any future applications, but NatWest will need to give any applications fair and reasonable consideration based on what I have said.

I still don't think I can fairly ask NatWest to restructure the mortgage to lend Mr S and Mr W the full amount of money they applied for based on what I've said above. However, NatWest should take into account what they know now for any future applications.

I previously said that NatWest should pay Mr S and Mr W £600 for the distress and inconvenience they have been caused but I now don't think that NatWest have done

anything wrong because they didn't know. So I won't be asking NatWest to make any payment to Mr S and Mr W.

I appreciate that Mr S and Mr W will be disappointed with my decision as they would like the mortgage to be restructured, but I'm satisfied that NatWest fairly assessed their mortgage application based on what they knew at the time.

My final decision

For the reasons given above and in both my provisional decisions, I uphold this complaint and direct National Westminster Bank to:

- give careful consideration to any future applications that Mr S and Mr W make, taking into account his increased disposable income due to not being liable to UK tax. And NatWest should take into account the Equality Act and make a reasonable adjustment to the income multiplier cap to ensure that Mr W is not being disadvantaged compared to other customers who do pay tax and NI

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr S and Mr W to accept or reject my decision before 6 February 2024.

Maria Drury
Ombudsman