DRN-4315503

The complaint

Mr O has complained about the early repayment charge ("ERC") he incurred when he redeemed his mortgage with Clydesdale Bank Plc trading as Virgin Money.

He feels it is unfair that such a large ERC was charged when his fixed rate mortgage product was so close to the end of its term.

What happened

Mr O took out this mortgage in February 2018. The mortgage offer dated 29 December 2017 indicated the rate was fixed at 2.28% until 1 April 2023, with an ERC being due if the mortgage was repaid before that date.

The ERC was explained as:

> *"If you transfer to a new mortgage product with Virgin Money plc or repay your mortgage in full before 1 April 2023 (the Early Repayment Charge period), you will be charged an Early Repayment Charge.*
>
> *The Early Repayment Charge is calculated as 4.00% of the outstanding loan balance at the date when either the loan is repaid or you transfer to a new mortgage product."*

In January 2023 Mr O was moving house and was taking a new mortgage with a different lender. He complained to Virgin Money about the ERC, and Virgin Money didn't uphold the complaint.

One of our Investigators looked at the complaint. She said the ERC was outlined in the mortgage offer, and it isn't calculated just on the amount of interest that would have been charged for the remaining term.

Mr O didn't agree and so 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.

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 O'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 O; certainly, the information about the ERC was set out in a manner that met the regulator's requirements. So I'm persuaded Mr O knew – or at least should have known – how much he'd have to pay if he repaid the mortgage before 1 April 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. 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. Virgin Money is entitled to set an ERC based not on the actual cost to it of Mr O 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 Virgin Money 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; Virgin Money 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.

Virgin Money 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 Virgin Money 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 O.

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

Mr O has said *"If Virgin can demonstrate that they have incurred all of these costs then I will of course accept the ruling, however, if Virgin have incurred costs at any amount less than what I have paid then I think it is only fair that the difference is repaid to me."*

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.

Virgin Money couldn't have known, in 2018, that Mr O 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 O chose to end the mortgage. Equally, things could have gone a different way, with Mr O choosing to end his mortgage early in the term and at a time interest rates were lower than when he took out his mortgage. In that instance Virgin Money wouldn't make Mr O pay more to cover any additional potential losses, and equally Virgin Money 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:

- Virgin Money was entitled to charge Mr O the ERC set out in his mortgage contract when he repaid his mortgage early.
- There was no requirement for Virgin Money to only charge an amount worked out based on Mr O's individual mortgage 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.
- Virgin Money didn't have to treat Mr O any differently to any of its other customers that redeemed their mortgage whilst there was an ERC in force.

For all the reasons given I don't think Virgin Money 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 O to accept or reject my decision before 8 November 2023.
Julia Meadows
Ombudsman