DRN-4268376

Financial Ombudsman Service

The complaint

Miss B has complained about a secured (second charge) loan she held with Bank of Scotland plc trading as Halifax. Halifax wrote off the remaining debt in November 2022 and Miss B thinks Halifax should refund her interest she says she's overpaid.

What happened

Miss B took out this loan in June 2004. The loan agreement Miss B signed shows she borrowed £25,000 over a 25-year term at a monthly interest rate of 0.510% (variable). This gave an initial monthly payment of around £160. There was an additional amount paid each month towards a payment protection insurance policy but that doesn't form part of this complaint so I won't make any further mention of that.

Some payments were missed over the years, and other payments were made late. The last payment Miss B made to the account was in December 2020 at which time the balance stood at around £11,700.

In November 2022 Halifax wrote off the outstanding debt of around £12,400.

Miss B complained to Halifax, saying she was due a refund of interest she'd paid over the term of the loan.

Halifax didn't uphold the complaint. It said interest had been calculated daily and added to the account monthly in line with the terms and conditions of the account, so any interest already added to the account before the loan was written off had been correctly charged. It said it had made a commercial decision not to require Miss B to pay the £12,400 she still owed it.

Miss B referred her complaint to our service and it was looked at by one of our Investigators. Our Investigator said interest had been charged monthly on the loan so, at the point the loan was written off, no interest had been added to the debt in advance. She said the interest rebate Miss B seemed to be referring to as part of the Consumer Credit (Early Settlement) Regulations 2004 isn't applicable as that is for loans where the interest due over the whole loan term is added to the debt at the start, so some is refunded if it is paid off early.

Miss B didn't agree and so the case 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.

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.

I think at the crux of this complaint is a misunderstanding about how Miss B's loan interest was calculated. To try to help I will first explain, in more general terms, about how loan interest can be calculated. I will then talk about Miss B's specific loan.

There are two ways the interest can be calculated on loans like this:

Option one – which is how Miss B's loan worked

Miss B had a daily interest loan so when she made a payment her interest was calculated the following day based on that new lower balance; that's the daily interest element.

The easiest way to think about this is using an example of a customer with a loan of £25,000 and a contractual monthly payment of £160 (all figures are rounded and approximate, and just for illustrative purposes):

- An opening balance of £25,000.
- Month one £135 goes to cover the interest, which leaves £25 to go to repay the debt. So the loan balance is now £24,975.
- Month two the payment stays the same, so they still pay £160. As the balance is lower, £134 goes to cover the interest, leaving £26 to reduce the debt. The balance is now £24,949.

That would then continue throughout the life of the loan. The interest is added each month based on what the balance has been on a daily basis throughout that month. That is how Miss B's loan worked.

Based on the original loan agreement, if Miss B's loan had run for its full 25-year term and she'd made all her payments in full and on time, she would have paid around £49,100 in loan payments (including interest).

Option two – which was not how this loan was calculated

The early settlement rebate Miss B has mentioned relates to loans that have been worked in a different way. Some lenders added all the interest onto the loan upfront. Using the same figures as an example (so a customer borrowing £25,000 with a contractual monthly payment of £160), instead the lender would have used an opening balance of £49,100 (that is, the total amount the lender expected the customer to pay over the life of the loan).

A loan where all the interest is added on day one would, instead of the above, look like the following:

- An opening balance of £49,100 (rather than £25,000).
- Month one the full £160 comes off the balance, so the loan balance is now £48,940.
- Month two the payment stays the same, so they still pay £160. The full £160 again comes off the balance, so the loan balance is now £48,780.

To compare

In both scenarios, if the loan runs for the full term and all payments are made in full and on time, the customer will end up paying the same amount and both will end with the loan paid off at the end of the 25-year term.

The difference comes where a consumer (or in this case the business) decides to end the loan early.

In the first example (which is like Miss B's loan) as the interest due to that date has been added each month when it fell due then an early settlement rebate calculation isn't needed as the loan balance at the time of settlement doesn't include any extra interest that has been added but that wasn't yet due. So if the loan balance is £17,000 then the consumer pays £17,000 to redeem the loan.

In the second example there would be an early settlement rebate calculation because the loan balance includes all the interest due over the entire term of the loan, so the business would need to take into account in its redemption statement calculation a rebate of the interest that had been added but will now never fall due as the loan has been repaid early. In this instance the loan balance might be £37,000, but of that £20,000 is interest that was added at the start but represents future interest at the point of redemption. The business would carry out an early settlement rebate calculation when generating a redemption statement and that would show the £37,000 balance, the £20,000 interest rebate and would ask the consumer to pay the £17,000 difference to redeem the loan.

Again, the consumer pays the same amount, it is just the method of calculation to get there that differs.

Miss B's loan specifically

The starting point of this complaint is that Miss B borrowed £25,000 and agreed to pay that sum back, plus monthly interest at a rate of 0.510% (variable). As an example, in January 2010 Miss B paid around £132 towards her loan and of that £65 was interest. That means, using that January 2010 example, Miss B was reducing her loan balance by around £67 a month. As I've explained above, each month Miss B made a payment towards her loan a little more of her payment would go towards reducing the balance and a little less would go towards paying the interest.

At the point Halifax wrote off the balance the debt stood at around £12,400. As that balance only included interest that had already fallen due before that time, there was no need for an interest rebate calculation to be undertaken. That's because the balance didn't include any future interest amounts.

Halifax didn't have to write off the balance of Miss B's loan. Had it not done so Miss B still would have owed £12,400 in November 2022 and that balance would have increased every month with the addition of the interest due. As the loan was secured on Miss B's property Halifax could have looked to take legal action, potentially to seek possession of Miss B's property.

When Miss B took out this loan she agreed to pay interest on the amount she owed, up until the point the loan was repaid. That interest was always due, and there are no grounds for me to order Halifax to refund any interest she did pay between 2004 and December 2020; and she didn't pay any interest after that point as she stopped making her payments, and Halifax wrote off everything after that point.

I can see how strongly Miss B feels about this, but Halifax hasn’t overcharged her any interest and, in fact, instead wrote off around £12,400 that she fairly owed it. Having considered everything very carefully there are no grounds for me to uphold this complaint.

I can see that Miss B has raised some other points as part of our investigation. This decision only relates to the closure of her secured loan. If Miss B wants to complain about any other issues then, as our Investigator explained, she will need to raise them with the business directly.

My final decision

I don’t uphold this complaint

Under the rules of the Financial Ombudsman Service, I’m required to ask Miss B to accept or reject my decision before 9 January 2024.

Julia Meadows
Ombudsman