



<u>Decision Ref:</u>	2021-0207
<u>Sector:</u>	Banking
<u>Product / Service:</u>	Fixed Rate
<u>Conduct(s) complained of:</u>	Fees & charges applied (mortgage) Errors in calculations
<u>Outcome:</u>	Rejected

**LEGALLY BINDING DECISION
OF THE FINANCIAL SERVICES AND PENSIONS OMBUDSMAN**

The complaint concerns a mortgage loan.

The Complainants' Case

The Complainants submit that they moved their mortgage to the Provider, against which this complaint is made, in **December 2018** and fixed the interest rate for a period of ten years. They state that in **January 2020**, they made a 10% capital repayment, intending to shorten the term of the loan. The Complainants contend that they subsequently received correspondence from the Provider, which stated that their monthly repayment was being reduced and that the original term of the loan remained. The Complainants state that in **December 2019**, the Provider quoted them a breakage fee of €25,474 to exit the fixed term. They further state that they do not intend to fully repay their mortgage early, but that they would like to be able to make additional repayments on occasion.

The Complainants contend that the Provider's calculation of the breakage fee does not comply with the European Union (Consumer Mortgage Credit Agreements) Regulations 2016, and they set out the reasons for this contention in their submissions.

The Complainants submit that the Provider's response to their complaint does not fully address their complaint, except to state that they had "*signed an agreement for a fixed term*".

The Provider's Case

The Provider, in its Final Response Letter, states:

"We are satisfied that the BFF calculation method used by [the Provider] was set out for you within your loan offer in a clear and unambiguous manner. We consider that you were fully on notice that a BFF could apply should you break out of the rate and that you were also informed in detail of the method used to calculate same".

The Provider also refers to Section 26 of the Regulations in its Final Response and details its financial loss in the event of an early repayment of the Complainants' mortgage loan.

In relation to the alteration of the Complainants' scheduled repayments, the Provider states in its Final Response that Clause 8.6 of the Complainants' Letter of Loan Offer outlined the circumstances whereby the Provider might vary the Complainants' repayment amount.

The Provider also sets out *"a number of flexible repayment options"* available to the Complainants.

The Complaints for Adjudication

The complaint is that the Provider has poorly administered the Complainants' mortgage loan.

The Complainants want the Provider to:

1. Allow them to make monthly repayments of €2,204 per month (rather than the reduced payment of €1,970) for the remainder of the fixed term;
2. Waive any breakage fee.

Decision

During the investigation of this complaint by this Office, the Provider was requested to supply its written response to the complaint and to supply all relevant documents and information. The Provider responded in writing to the complaint and supplied a number of items in evidence. The Complainants were given the opportunity to see the Provider's response and the evidence supplied by the Provider. A full exchange of documentation and evidence took place between the parties.

In arriving at my Legally Binding Decision, I have carefully considered the evidence and submissions put forward by the parties to the complaint.

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Having reviewed and considered the submissions made by the parties to this complaint, I am satisfied that the submissions and evidence furnished did not disclose a conflict of fact such as would require the holding of an Oral Hearing to resolve any such conflict. I am also satisfied that the submissions and evidence furnished were sufficient to enable a Legally Binding Decision to be made in this complaint without the necessity for holding an Oral Hearing.

A Preliminary Decision was issued to the parties 31 May 2021, outlining my preliminary determination in relation to the complaint. The parties were advised on that date, that certain limited submissions could then be made within a period of 15 working days, and in the absence of such submissions from either or both of the parties, within that period, a Legally Binding Decision would be issued to the parties, on the same terms as the Preliminary Decision, in order to conclude the matter.

In the absence of additional submissions from the parties, within the period permitted, I set out below my final determination.

Prior to considering the substance of the complaint, it will be useful to set out the relevant terms and conditions from the Complainants' account as well as the legislation relied upon by the Complainants.

Terms and Conditions of the Account

The Provider relies on the following provision set out in the Letter of Offer in relation to break funding fees:

If during the Fixed Rate period, the Borrower redeems in whole or in part or converts the Loan into a variable interest rate or to another fixed rate loan, on that date (the "switching/redemption date"), a break funding fee will be payable to the Lender. If, at the switching/redemption date the Fixing Rate (as defined in the formula) is higher than the Fixing Rate at the date the existing fixed rate applying to the Loan was set, no break funding fee arises. If, however, at the switching/redemption date the Fixing Rate is lower than the Fixing Rate at the date the existing fixed rate applying to the Loan was set, then a break funding fee will be chargeable. The break funding fee will be calculated by reference to the formula set out in the Statutory Warnings section of the Letter of Offer.

The said formula was set out in the following terms:

$$B = (W - M) \times T / 12 \times A \text{ where:}$$

B = the Break Funding Fee.

W = the Wholesale Rate prevailing at the date of the existing fixed rate applying to the loan was set.

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M=the Wholesale Rate prevailing at the switching/redemption rate for the unexpired time period of the Fixed Rate period.

T=Period of time in months to the end of the Fixed Rate period.

A=Principal amount which is subject to the existing fixed rate and which is being switched or redeemed.

“Wholesale Rate” means the rate per cent per annum which the Lender determines to be the market rate applying to an appropriate interest rate swap for the relevant time period.

European Union (Consumer Mortgage Credit Agreements) Regulations 2016

The Complainants identify the following provisions in support of their complaint:

26. (1) A consumer has a right to discharge fully or partially his or her obligations under a credit agreement prior to the expiry of that agreement. In such cases, the consumer shall be entitled to a reduction in the total cost of the credit to the consumer, such reduction consisting of the interest and the costs for the remaining duration of the contract.

26(2) A creditor shall be entitled to fair and objective compensation, where justified, for possible costs directly linked to the early repayment, but shall not impose a sanction on the consumer, and any such compensation shall not exceed the financial loss of the creditor.

26(3) Notwithstanding paragraph (2) and without prejudice to paragraph (4), a creditor’s entitlement to compensation under this Regulation shall arise only in the circumstances where the borrowing rate provided for in the credit agreement:-

- (a) may not be changed, or*
- (b) may not be changed over a period of at least one year, or*
- (c) may not, for a period of at least five years, exceed the rate applicable on the date of the making of the credit agreement by more than two percent.*

26(4) A creditor shall not in any event be entitled to compensation under this Regulation in respect of—

- (a) subject to subparagraph (b), any period of the credit agreement that remains after early repayment,*

(b) if the case is one falling within subparagraph (b) or (c) of paragraph (3) and the early repayment occurs before the expiry of the period referred to in that subparagraph, any period of the credit agreement that remains after the expiry of the period so referred to.

Analysis

The Complainants take issue with two matters, one of which has resolved in that the Complainants have been facilitated in their desire to maintain their monthly repayments at or near the level that repayments were being made prior to the lump sum repayment in January 2020. The Provider states that it was not possible to do this until a formal instruction was provided but that it has now been done and has resulted in the mortgage term being shortened.

I note that the Complainants' account had a term of 15 years when it was transferred to the Provider in 2018 and that the arrangement reached between the Complainants and the Provider was that the interest rate would be fixed for a period of 10 years.

The remaining aspect of the complaint relates to the manner in which the Provider calculates the breakage fee applicable in the event that the Complainants wish to exit their fixed term mortgage agreement prior to the end of the fixed term. Pursuant to the terms of the account, any further ad hoc lump sum payments by the Complainants would trigger this breakage fee in circumstances where the Complainants have already reached the maximum threshold allowable under the terms of 10% of the balance outstanding (the January 2020 payment having been for precisely 10% of the balance outstanding at the time).

Whilst the Complainants state that they "*do not intend to fully repay [their] mortgage early*", they also state that they made the lump sum capital repayment in January 2020 "*intending to shorten the term*". They also express a desire "*to be able to make additional payments where possible*"; this would inevitably result in the account being repaid early and indeed the Complainants do not believe, pursuant to the Regulations discussed below, that the Provider can "*force [them] to retain the original mortgage term*".

It would appear that there is some confusion and/or inconsistency as to the objectives of the Complainants. However, I am satisfied that this is not something that I need to resolve. The Complainants have challenged the break fee calculation formula employed by the Provider on the specific ground that, in this instance at least, it does not comply with the European Union (Consumer Mortgage Credit Agreements) Regulations 2016 (hereinafter referred to as 'the Regulations'). This claim stands or falls regardless of the intentions of the Complainants.

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Prior to embarking on a consideration of the break fee mechanism's compliance with the Regulations, it is important to point out that the Complainants concede that the loan terms to which they agreed provided for the manner of calculation of the break fee as now challenged. The Complainants contend however that this mechanism does not result in "*fair ... compensation*" as required under the Regulations. On the contrary, the Complainants contend that the mechanism constitutes a "*sanction*" which is prohibited under the same Regulations.

The Complainants' argument is premised on a number of complex and clearly articulated factors but, essentially, they contend that, in light of the trajectory of inter-bank funding markets since the opening of the account with the Provider and, specifically, in light of the fact that the Provider has not experienced an increase in its own borrowing cost in that period, it should be accepted that the Provider would not incur any (or any substantial) "*costs*" in the event that the Complainants were to exercise their right to repay their loan early. The Complainants point out, additionally, that any funds repaid early by them would be available to the Provider to lend to other customers at a rate equally favourable to the rate to which the Complainants' account is subject.

The Provider rejects the Complainants' reasoning in insisting that there is a cost to it in "*in terms of breaking the fixed rate*". In terms of the specifics of that cost, the Provider stated as follows in its response to this office:

The ability to offer competitive fixed rate mortgages is facilitated by the availability of hedging instruments and interest rate swaps, to allow [the Provider] manage the interest rate exposure created by fixed rate mortgages. The instruments [the Provider] transacts to manage its interest rate exposure and the basis for calculating the break funding fee, which is available via our website at [redacted] are based on wholesale rates.

The wholesale rate is the rate per cent per annum which [the Provider] determines to be the market rate applying to an appropriate interest rate swap for the relevant time period. When an existing fixed rate mortgages is redeemed and [the Provider] no longer has that fixed rate mortgage, the requirement for the interest rate swap at the time the rate was fixed is no longer needed and thus there is a cost breaking the fixed interest rate.

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To reiterate, the breakage fee does not include any profit for [the Provider]. The breakage fee represents a real cost to [the Provider] which has entered into commitments to fund the particular rate provided in the fixed rate agreement and [the Provider] must continue the commitment regardless of whether the Complainants remain in the rate or opt to break out. As such, there is no room for negotiation on the costs involved as to reduce the breakage fee would result in an immediate and ongoing loss for [the Provider].

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I am not persuaded by the argument advanced by the Complainants. In particular, I cannot accept their reasoning as to what constitutes a cost to the Provider withstands scrutiny. Indeed, the Complainants themselves speculate that "*hedging from fixed to floating rates and other complexities may be at play*" but they seem to me to incorrectly deduce that these factors are not accounted for within the Provider's formula. On the contrary, it appears to me that these factors form a central aspect of the 'wholesale rate' variation built into the formula.

In the circumstances, I accept that the Provider has demonstrated that it has suffered a cost and that the break fee calculated by it is directly linked to that cost. I also accept that the Provider has established that the break fee does not constitute an amount greater than "*the financial loss of the creditor*" and that it does not represent a "*sanction on the consumer*". I note in this regard that the Provider has stated that the breakage fee reflects a "*real cost*" to it and does not account for "*the loss of interest expected from the mortgage holder*" and "*does not include any profit for*" the Provider. In summary, I am not satisfied that the Complainants have demonstrated that the break fee does not constitute "*fair and objective compensation*".

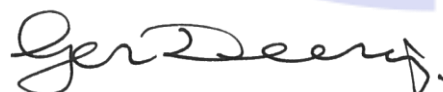
The Complainants also contend that the mechanism employed by the Provider is in breach of Regulation 26(4)(b) in that it is calculated by reference to the total principal amount in respect of the entire remaining term of the loan rather than in respect of "*the principal to be repaid during the fix period*". I am not satisfied that the Complainants have demonstrated any breach in this regard. Regulation 26(4)(b) prohibits the taking into account of "*any period*" beyond the fixed rate period. It is clear that the Provider has not done this and that the period that is taken into account in the formula ('T') is the "*[p]eriod of time in months to the end of the Fixed Rate period*".

For the reasons set out in this Decision, I do not uphold this complaint.

Conclusion

My Decision pursuant to **Section 60(1)** of the **Financial Services and Pensions Ombudsman Act 2017**, is that this complaint is rejected.

The above Decision is legally binding on the parties, subject only to an appeal to the High Court not later than 35 days after the date of notification of this Decision.



**GER DEERING
FINANCIAL SERVICES AND PENSIONS OMBUDSMAN**

22 June 2021

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Pursuant to *Section 62 of the Financial Services and Pensions Ombudsman Act 2017*, the Financial Services and Pensions Ombudsman will publish legally binding decisions in relation to complaints concerning financial service providers in such a manner that—

(a) ensures that—

(i) a complainant shall not be identified by name, address or otherwise,

(ii) a provider shall not be identified by name or address,
and

(b) ensures compliance with the Data Protection Regulation and the Data Protection Act 2018.

