



<u>Decision Ref:</u>	2021-0434
<u>Sector:</u>	Banking
<u>Product / Service:</u>	Variable Mortgage
<u>Conduct(s) complained of:</u>	Increase in interest rate
<u>Outcome:</u>	Rejected

LEGALLY BINDING DECISION OF THE FINANCIAL SERVICES AND PENSIONS OMBUDSMAN

The Complainants entered into a mortgage loan agreement with the Provider in **August 2010**, which agreement provided for repayments at an initial fixed rate of interest for five years, reverting to a variable rate of interest thereafter.

The Complainants contend that they have been overcharged on their mortgage loan by the Provider and that the Provider has acted wrongfully and/or unreasonably in applying the variable rates of interest which it has, to their loan. They submit that the relevant clause in the mortgage agreement does not provide for a basis upon which the Provider may alter the variable rate of interest and as a result, represents an unfair term in a consumer contract, within the meaning of the Unfair Terms in Consumer Contract Regulations, 1995, as amended.

The Complainants' Case

The Complainants submit that at the time of taking out the mortgage, in 2010, *“in light of the uncertainty around the direction of interest rates in Europe, we opted for an initial 5 year fixed mortgage at 4.25 % reverting to a variable rate after 5 years”*.

The Complainants submit that on **11 August 2015** they were notified by the Provider that the fixed term rate would expire at the end of that month and would revert to the Provider's then current variable rate of interest, of 3.97%.

The Complainants submit that the indicative variable rate quoted in the original loan offer in 2010 was 3.85%. They say that it was a cause of concern to them then that they were to be charged interest at a higher rate than had been quoted, in circumstances where

“ECB rates had fallen in the intervening period and the funding ability of Irish Financial institutions had improved significantly.”

The Complainants submit the loan documentation states only that the interest on the loan may be increased or reduced by the Provider from time to time but that it does not provide any reference to the basis upon which the Provider may make such adjustments.

The Complainants submit that they wrote to the Provider in **September 2015** seeking clarification as to why the rate of 3.97% to be applied at the end of the fixed rate period was higher than that which had prevailed in 2010, taking into account the fact that ECB rates had reduced by 1% and that the Provider’s cost of funds in the markets had improved since then. They also queried the basis upon which the Provider may make adjustments to the interest rate, with reference to the loan documentation.

They submit that the Provider’s response advised them that the Standard Variable Rates which were applied by it to their loan were based on its parent Group’s funding conditions and financial performance. They state that the Provider’s letter did not respond to their question as to where, in the loan documentation it sets out the basis upon which the Provider may make adjustments; instead it pointed them to the fact that the loan documentation stated that the rate may be adjusted by the Provider from time to time.

On **30 August 2016**, the Complainants received a formal response to the complaint they had submitted on **17 February 2016**. Whilst the Provider explained that its mortgage pricing reflects its operational running costs, the cost of risk attached to a mortgage loan and the cost of funding the mortgage portfolio, the Complainants submit that none of this information was disclosed in their mortgage agreement and that it cannot now be unilaterally included by the Provider in their agreement.

The Complainants contend that the Provider has acted wrongfully in omitting to include any basis for changing the variable rate applied to their mortgage agreement and in effectively reserving its right to do so at its complete discretion. The Complainants’ position is that, in the circumstances, the clause in question breaches the Unfair Terms in Consumer Contracts Regulations 1995, as amended.

The Complainants submit that, as a result of the Provider’s actions in this regard and the manner in which it has applied the variable interest rates of interest to their loan, they have been overcharged on their mortgage.

The Provider’s Case

/Cont’d...

The Provider notes that the Complainant drew down the mortgage on **6 August 2010** on a fixed interest rate of 4.25% for a term of 5 years. The loan offer letter dated **27 July 2010** confirmed that the interest rate after 5 years would be "*Variable (currently 03.85%)*"

The Provider submits that it wrote to the Complainant on **11 August 2015** confirming the fixed interest rate term would expire at the end of **August 2015** and that the variable rate applicable at that time was 3.97%. The Complainant emailed the Provider on **3 September 2015** querying the variable interest rate applicable. The Provider responded on the **4 September 2015** directing the Complainants to their Mortgage Broker.

The Complainant emailed the Mortgage Broker on the **7 September 2015** querying the variable interest rate applicable after the expiry of the fixed rate. The Mortgage Broker sent this request to the Provider on the **7 September 2015**, which responded to the Complainants on the same day and confirmed the applicable variable interest rate as 3.97%.

On **9 September 2015**, the Complainant requested a formal complaint be raised, to include the issue of why the variable interest rate was higher than the indicative rate quoted in the loan offer letter of 2010.

The Provider acknowledged the complaint on the **9 September 2015** and issued a holding letter on **9 October 2015**. On **27 October 2015**, it issued a final response letter to the Complainant on the matters raised by the Complainant.

The Complainant wrote a letter on **17 February 2016** to raise a formal complaint on the "*overcharging on our account*". In particular, the Complainants contended that the contract term in question violated the Unfair Terms in Consumer Contracts Regulations, 1995 as amended.

The Provider issued an acknowledgement letter to the Complainant on **18 February 2016**. A holding letter was issued on **16 March 2016** and two further holding letters issued on **13 April** and **24 May 2016**.

The Provider submits that a holding letter issued on **24 May 2016**, which confirmed that it would revert no later than **21 June**, however the next correspondence that issued was the final response letter dated **30 August 2016**. The Provider has submitted that it apologises that its final response letter was not issued in line with the Consumer Protection Code regulatory timelines and it has offered €400 to the Complainants, in recognition of this customer service failure.

The Provider submits that its final response letter to the Complainants outlined that there are a number of deciding factors which it has to take into account when setting its rates and that ECB rates only makes up a small percentage of its funding. It says that the setting of interest rates is a carefully considered process, which goes through procedures at Group level.

The Provider submits that the Letter of Loan Offer outlined the fixed rate applicable to the loan as being **4.25%** and it indicated the nominal rate after the expiry of the 5 year fixed interest rate period as **3.85%**, this being the prevailing variable interest rate at the date of issue of the Letter of Loan Offer.

The Provider states that it has acted in accordance with its legislative obligations in this regard and that the terms referred to by the Complainants are in plain and intelligible language. It says that, in keeping with the requirements under the Consumer Credit Act, 1995 "the Front Page Information box" of the loan details advised that:

"THE PAYMENT RATES ON THIS HOUSING LOAN MAY BE ADJUSTED BY [Provider] FROM TIME TO TIME (does not apply while the loan is at a fixed rate)."

It states that the "**Important information**" required under section 129 of the Act was provided on the first page of the Letter of Loan Offer dated 27 July 2010.

The Provider's position is that the Unfair Terms in Consumer Contracts Regulations, 1995 as amended, are not applicable to the clause in question. Alternatively, the Provider refutes that it has violated the Regulations as its mortgage rates are constantly under review and are set based on market conditions.

The Provider submits that it is not required to disclose the basis of how it charges its rates as this is a commercially sensitive calculation and the rates charged by any lender depend on each lender's own individual costs, risks, operating costs and market forces.

It says that it has acted reasonably in the setting of its interest rates and the variable rates applicable to the Complainants' mortgage loan compare very favourably in the market and could not be said to be excessive.

The Provider rejects the Complainants' contention that they have been overcharged on their loan.

The Complaint for Adjudication

The Complainants' complaint is that they have been overcharged by the Provider on their mortgage loan, with reference to the variable rates of interest which have been applied by the Provider, on the basis of Clause 3.2 of the Mortgage Agreement. They say that this clause is unfair within the meaning of the European Union (Unfair Terms in Consumer Contracts) Regulations 1995, as amended, as it does not provide for a basis upon which the Provider may alter the variable rate of interest.

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.

/Cont'd...

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

Whilst the Complainants have indicated their opinion that "*there are clear conflicts of fact that go to the heart of the case*", I am satisfied that the conflict in the respective positions adopted by the parties, are not such that oral evidence is required to be taken; rather the parties have been given every reasonable opportunity to make their submissions in writing and these submissions have been shared as between the parties and both have been given the opportunity to comments on the other party's observations.

A Preliminary Decision was issued to the parties on **9 November 2020**, outlining the preliminary determination of this office 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. Following the consideration of additional submissions from the parties, the final determination of this office is set out below.

The Complainants entered into a mortgage loan agreement with the Provider in **2010**. The Complainants' complaint arises in circumstances where the indicative variable rate referred to in the Letter of Loan Offer of 2010 was 3.85% but when the mortgage subsequently reverted to a variable rate, that rate was 3.97%.

At the time when the preliminary decision of this Office was issued, it was noted that the Complainants were dissatisfied with the fact that no basis for the Provider's setting of its variable rate, is provided for within the loan documentation; they contended that as a result, they had been overcharged on their loan.

Since the preliminary decision was issued by this Office, the Complainants have contended that:

"This statement is actually an inappropriate reversal of our position and does not take full account of our position. We believe the order, to be material to the case. In setting out the background to the case you have presented the order correctly, namely, that we contend we have been overcharged in the first instance and secondly that they have acted wrongly or unreasonably as there is no basis set out in the agreement making it unfair. Critically as well, we also contend that this unfairness is perpetuated by the actions of "the state", the owners of [Provider] through its actions in interfering in the market place to provide stability to the financial system, but in doing so not prioritising consumer protection as it pertains to our mortgage, resulting in overcharging by [Provider] of us. There is a natural

/Cont'd...

unfairness to participating in playing the game and setting the rules at the same time if our consumer interests are not fully protected by the rule setter.”

Any such issue concerning the setting of interest rates by virtue of the involvement of the State, is not a matter for the FSPO and rather is a matter to be raised directly with the Central Bank of Ireland in its capacity as regulator of financial service providers. It must also be noted that the FSPO has no role to play regarding the actions of the State, and likewise, has no role to play in examining the ultimate ownership of any individual financial service provider. Rather, the jurisdiction of the FSPO is limited to investigation of any complaint made by a consumer (within the meaning of the **Financial Services and Pensions Ombudsman Act 2017**, as amended (“the Act”)) concerning the conduct of an individual financial service provider or pension provider. Such a complaint can be rejected or can be upheld on any of the grounds set out at **section 60** of the Act.

In examining the details of the Complainants’ complaint that they have been overcharged by the Provider, I have had regard to the Loan Documentation furnished in evidence in this complaint.

The Letter of Loan Offer dated 27 July 2010 set out the following details of the loan agreement:

<i>Total Amount of Loan</i>	<i>€584,000.00</i>
<i>Monthly repayment: (Yrs 1-5)</i>	<i>€2,872.93 (See Important Note)</i>
<i>Interest Rate (Yrs 1-5)</i>	<i>4.25% (See Important Note)</i>
<i>After 5 years:</i>	<i>Variable (currently 03.85%)</i>
<i>Repayment Period (Years):</i>	<i>30 Approx</i>

The European Standardised Information Sheet which was furnished to the Complainants stated, *inter alia*:

Nominal rate 4.25%
After 5 years the interest rate will be 3.85%

...

The figures are provided in good faith and are an accurate representation of the offer made under current marketing conditions based on the information which has been provided. It should be noted, however, that the figures could fluctuate with market conditions. This document does not create a legally binding offer...

[my underlining added for emphasis]

Consumer Credit Act 1995

As the Complainants entered into the loan agreement in 2010, the relevant provisions of the Consumer Credit Act 1995 apply. I note in this regard that the Letter of Loan Offer contained the following warnings, on its face, as stipulated by section 128 of the 1995 Act:

/Cont’d...

Warning: Your home is at risk if you do not keep up payments on a mortgage or any other loan secured by it.

The payment rates on this housing loan may be adjusted by [the Provider] from time to time (Does not apply when the loan is at a fixed rate.)

I also note that the Letter of Loan Offer, dated **27 July 2010**, set out the following “Principal Details of The Loan”, as per the stipulation within section 129 of the Act:

IMPORTANT INFORMATION AS AT 27/07/10

1. Amount of credit advanced	€584,000.00
2. Period of Agreement	30 years
3. Number of repayment instalments (may vary – see [Provider loan] Conditions)	360
4. Amount of each instalment*	€2872.93
5. Total amount of credit repayable	€999,016.80
6. Cost of this credit (Point 5 minus 1)	€415,016.80
7. APR**	4.1%
8. Amount of endowment premium*(if applicable)	Not Applicable
9. Amount of mortgage protection premium *(if applicable)	Not Applicable
10. Effect on amount of instalment of 1% increase in first year in interest rate	
€351.94 pm	

* As calculated at the time of making agreement

** annual percentage rate of charge

*** this is the amount by which the instalment repayment will change in the event of a 1% increase in the interest rate on which the above calculations are based.

Mortgage Loan Conditions

Section 3 and more specifically section 3.2 of the mortgage conditions, is contended by the Complainants to comprise an unfair term, per the Unfair Terms in Consumer Contracts Regulations 1995, as amended, because it does not include any basis for the Provider altering the variable rate:

3. **Interest on the Loan**
 - 3.1 The basis on which the interest rate on the Loan is calculated is stated in the Offer Letter.
 - 3.2 The interest rate on the Loan may be increased or reduced by [the Provider] from time to time, however no change in the interest rate will be applied to the Loan during any period when the interest rate is a fixed rate.
 - 3.3 Notice of a change in the interest rate on the loan will be given by way of a notice in writing sent to the Borrower, or by:
 - (a) a notice exhibited at the registered office of [Provider], and
 - (b) a notice in at least two national daily newspapers.

/Cont'd...

The change in interest rate on the Loan will take effect on the day specified in the notice.

I note that the Complainants queried the variable rate applicable to their mortgage with the Provider in the course of correspondence, beginning in **September 2015**.

Correspondence

On **03 September 2015** the Complainants emailed the Provider, noting that whilst it had confirmed that the variable rate of interest of 3.97% was correct, they identified that 3.85% had been indicated in the loan agreement, and they queried:

“in the intervening period we understand the ECB rates have reduced by 1% and that your actual cost of funds in the markets have improved significantly. Has something else changed since we accepted your Loan offer that we should be aware of?”

The Complainants advised that they could see no reference within the loan conditions or the principal details of the loan, which provided the basis for such adjustments, apart from the fact that they may be adjusted by the Provider, from time to time.

They asked for confirmation as to where this basis was detailed within the loan documentation. The Provider’s response was to, initially, and incorrectly, advise them that they would require the assistance of their broker to deal with their query. Having secured that assistance, they then received an email from the Provider of **07 September**, which advised them that the rate of 3.97 % was the Provider’s then current standard variable rate and that:

“the rates quoted when you fixed and market changes since then are quite different – these were indicative rates.”

The Complainants proceeded to raise a formal complaint by email of the **09 September 2015**. Noting the Provider’s above comment, they enquired as to

“Which markets are you referring to and how have these impacted the rate quoted? Is it the money markets where you source funding or the lending markets in Ireland where you operate? I had comprehended that things are different 5 years later and that the rate quoted of 3.85% while “Current” at the time was indicative. What I have not comprehended is why the rate quoted now is higher noting the circumstances I previously outlined.”

The Complainants also reiterated their request for advice as to where in the loan documentation the basis for such adjustments was provided. On **27 October 2015** the Provider issued its Final Response Letter to the Complainants and responded to the questions raised in their previous correspondence.

With regard to the markets it obtained funds from, the Provider stated

/Cont’d...

"[The Provider] is dependent on its ultimate Parent [name] for continued funding. The Group maintains access to a variety of sources of wholesale funds, including those available from money markets, repo markets and term investors."

As to why the then variable rate, was higher than the variable rate when the loan was taken out, the Provider responded that

"The interest rate structure on your loan is a standard variable rate which does not track the ECB rate. [Provider]'s funding does not come solely from ECB borrowing."

It stated that the changes to its standard variable rates were, *"Based on [Parent Group's] funding conditions and financial performance"*.

With regard to where in the loan documentation the basis upon which the Provider may adjust the payment rates was detailed, it responded,

"on the front page 'information box' of the loan offer letter it states 'The payment rates may be adjusted by [Provider] from time to time. (Does not apply while the loan is on a fixed rate.)"

The Complainants responded by letter of **17 February 2016**, raising a formal complaint of overcharging on their account and expressing dissatisfaction that the Provider's response made no reference to the basis on which the Provider may adjust the interest on the Loan, other than to state that it may be done from time to time and that the mortgage documentation was *"unclear"* in this regard.

They asserted that

"the lack of clarity and ambiguity 'on the basis' of adjustment, violates the Unfair Contract Terms Directive 1993/13/ECC. There is a clear attempt by you to overcharge us ..."

The Provider's responded to the Complainants, by letter **30 August 2016** stating:

Please note [the Provider] is a wholly owned subsidiary of [parent group] but a separate entity to [parent]. [Provider's] mortgage pricing reflects our operational running costs, the cost of risk attached to a mortgage loan and the cost of funding the [Provider] mortgage portfolio. [Provider] obtains funding from a variety of sources, not just the European Central Bank (ECB). In fact the ECB only accounts for a small percentage of overall [Provider's] funding. The balance comes from significantly more expensive sources, including wholesale market funding, bonds and capital. [Provider] continues to actively review its pricing and mortgage offer in line with any changes to any funding costs and other market developments.

Alterations to the Variable Rates of Interest

/Cont'd...

I note that the following variable rates of interest have been applied to the Complainants' loan by the Provider since the expiry of the fixed rate period of interest of **4.25%** in 2015:

3.97% - By letter dated **11 August 2015** the Provider wrote to the Complainants stating that the fixed rate terms of their mortgage would expire at the end of the month and would revert back to the then "current variable rate" of **3.97%**.

3.72% - By letter dated **15 September 2015** the Complainants were informed that the interest rate on their loan was to decrease by 0.25% (from 3.97% to **3.72%**) effective from **01 October 2015**.

3.40% - By letter dated **19 July 2016** the Complainants were informed that the interest rate on their loan was to decrease by 0.32% (from 3.72% to **3.40%**) effective from **01 August 2016**.

3.15% - By letter dated **18 October 2017** the Complainants were informed that the interest rate on their loan was to decrease by 0.25% (from 3.40% to **3.15%**) effective from **01 November 2017**.

This is the rate confirmed by the Provider as at July 2020, as then currently applying to the Complainants' loan.

Unfair Terms in Consumer Contracts Regulations 1995

The European Communities (Unfair Terms in Consumer Contracts) Regulations, S.I. No. 27 of 1995, as amended¹ implemented Directive 93/13 on unfair terms in consumer contracts.

The Regulations provide that a consumer will not be bound by a standard term in a contract with a seller or supplier if that term is unfair, within the meaning of the legislation.

In examining the issues raised as part of the within complaint, I have noted the Supreme Court decision in 2019, in the case of *Pepper Finance Corporation (Ireland) DAC v Cannon* [2020] IESC 2, which provides useful guidance as to the application of the Regulations in the context of certain terms in mortgage agreements, including an interest variation clause, whereby the variable rate of interest would vary either upwards or downwards at the lender's discretion. The Court noted that:

The Irish legislation and authorities

112. The Directive was implemented in Irish law by the European Communities (Unfair Terms in Consumer Contracts) Regulations, 1995 (S.I. 27/1995, as amended in 2000

¹ As amended by the European Communities (Unfair Terms in Consumer Contracts) (Amendment) Regulations 2000, S.I. No. 307 of 2000 and the European Communities (Unfair Terms in Consumer Contracts) (Amendment) Regulations 2013, S.I. 160 of 2013.)

and 2013 in relation to matters not relevant here). The Regulations are, more or less, an exact reflection of the Directive insofar as the core principles and indicative list of terms that may be regarded as unfair are concerned.

Schedule 2 sets out brief guidelines for the application of the test of good faith – regard is to be had to the strength of the bargaining positions of the parties; whether the consumer had an inducement to agree to the term in question; whether the goods or services were sold or supplied to the special order of the consumer; and the extent to which the seller or supplier has dealt fairly and equitably with the consumer whose legitimate interests he has to take into account.

In respect of the interest variation clause or “price variation clause”, the Supreme Court identified as follows:

129. ...

In contending that they have a strong appeal, the appellants focus in particular on the “price variation” clause (that is, the provision that the interest rate would vary at the lender’s discretion), the “acceleration” clause (that is, the provision entitling the lender to demand early repayment of the principal and accrued interest in the event that any repayment was not made on the due date), the power to enter into possession of the property in the event of a missed payment or other breach on the part of the borrower and the “transfer of rights” clause (that is, the entitlement of the lender to sell on all or part of the security without notice to the borrower).

130. *In assessing any given contractual term for unfairness, it should be remembered, firstly, that the primary consequence of a finding that it is unfair is that it becomes unenforceable as against the consumer. The contract remains in being provided it can exist without the unenforceable term. Secondly, where an impugned clause was not in fact invoked against the borrower, it is examined only for the purpose of drawing such inferences as may be appropriate if it is found to be unfair. Such inferences must, it seems to me, relate to the question whether the lender has dealt with the borrower in good faith as defined by the regulations and Directive. Thirdly, the requirement to consider all of the circumstances means that the assessment of fairness should take into account inter alia any relevant EU provisions and any relevant aspects of the national regulatory regime with a view to the remedies against unfairness available to the consumer under national law. There is now in existence a wide range of consumer protection legislation which may apply to mortgages, and the following discussion should not be seen as exhaustive.*

131. On the face of it, the interest variation clause comes within the exemption in Article 2(b) of the Regulations (which relates to subparagraph (j) of the Annex to the Directive), permitting a supplier of financial services to reserve the right to alter the interest rate without notice where there is a valid reason, provided that the supplier is required to inform the other contracting party at the earliest opportunity and that the latter can dissolve the contract immediately. Of course, dissolving the contract will not extinguish the debt, which may limit the practical desirability of this option from a borrower’s point of view. However, there are other relevant considerations.

[my underlining for emphasis]

132. Prior to 2016 the primary information that had to be furnished to consumers entering into mortgage agreements was set out in the Consumer Credit Act 1995. This included a statement of the total cost of the credit being provided, and also a calculation of the effect of an increase in the interest rate of 1%. This information was provided to the appellants. The obligations in respect of information are now largely dealt with in the European Union (Consumer Mortgage Credit Agreements) Regulations (S.I. 142/2016), which, in addition to the information requirement already discussed, stipulate that the borrower must be informed of the change in the interest rate and of the consequent change in the payment instalments. As a result it may be that, depending on the circumstances, a failure to inform the borrower in due course would result in a court refusing to find that the extra sums claimed were due.

133. Another consideration is that if a lender were to attempt to apply an increased interest rate to sums due where a payment is late, then if such a rate is set at a level that is not fairly related to the costs of the lender, the clause is likely under Irish law to be found to constitute an unenforceable penalty by reference either to common law or to Article 29(2) of the European Union (Consumer Mortgage Credit Agreements) Regulations 2016.

134. It appears that in this case the lender reduced, rather than raised, the interest rate after the expiry of the fixed rate period. The consequence was that the monthly instalments were reduced from a figure in excess of €4,800 to c. €3,700. I cannot see that any inference of lack of good faith can be drawn from this, and nor does it support the contention that the total sum claimed might not have been due and owing. The appellants have not, therefore, put anything before the Court that could lead to a finding that they can make out any defence in relation to the interest variation clause.

Analysis

I note that, for the purpose of the Regulations, a contractual term shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer, taking into account the nature of the goods or services for which the contract was concluded and all circumstances attending the conclusion of the contract and all other terms of the contract or of another contract on which it is dependent.

Schedule 3 of the Unfair Terms in Consumer Contracts Regulations, known as the "grey list", contains a non-exhaustive illustrative list of contract terms, which may be found to be unfair, including:

1. Terms which have the object or effect of:

(j) enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract;

/Cont'd...

This list is however further subject to Article 2(b), by reference to which subparagraph (j) is stated to be:

Subparagraph (j) is without hindrance to terms under which a supplier of financial services reserves the right to alter the rate of interest payable by the consumer or due to the latter, or the amount of other charges for financial services without notice where there is a valid reason, provided that the supplier is required to inform the other contracting party or parties thereof at the earliest opportunity and that the latter are free to dissolve the contract immediately.

From this and from the Supreme Court's dicta as set out in some detail above, it appears to me that the interest variation clause, whereby the rate would vary either upwards or downwards at the lender's discretion falls, on the face of it, within the exemption provided for in Article 2(b) of the Regulations. The exemption carved out within Article 2(b) of the Regulations, as applicable to subparagraph (j), permits a supplier of financial services to reserve the right to alter the interest rate without notice, where there is a valid reason, provided that the supplier is required to inform the other contracting party at the earliest opportunity, and that the latter can dissolve the contract immediately.

I note that the Provider explained the basis of its rate setting within its Final Response letter to the Complainants dated **30 August 2016**, as follows:

[Provider's] mortgage pricing reflects our operational running costs, the cost of risk attached to a mortgage loan and the costs of funding the [Provider] mortgage portfolio. [Provider] obtains funding from a variety of sources, not just the European Central Bank (ECB). In fact the ECB only accounts for a small percentage of overall [Provider] funding. The balance comes from significantly more expensive sources, including wholesale market funding, bonds and capital. [Provider] continues to actively review its pricing and mortgage offer in line with any changes to funding costs and other market developments. As stated in the mortgage documentation and terms and conditions, the interest rate may be varied from time to time. Any adjustment in interest rate is governed by the factors mentioned above.

Although the Provider has advised that its mortgage pricing reflects its operational running costs, the cost of risk attached to a mortgage loan and the cost of funding the mortgage portfolio, nevertheless, the Complainants' position is that because no basis for variation was provided for, within their mortgage agreement, it cannot now be read into the loan agreement.

I note however that the exemption in question, permits a supplier of financial services to reserve the right to alter the interest rate without notice where there is a valid reason for the alteration and provided that the supplier is required to inform the other contracting party or parties thereof at the earliest opportunity and that the latter are free to dissolve the contract immediately. Having had regard to the reasons made available by the Provider in its Final Response Letter and re-iterated in subsequent submissions, I am of the view that it has supplied a valid reason for such alterations.

/Cont'd...

Since the preliminary decision of this Office was issued the Complainants have contended, amongst other things, that:

“We have provided clear evidence that overcharging has occurred, as outlined in our initial complaint. The rate charged at the end of the fixed rate period was higher than the indicative rate at the time of taking out the mortgage despite the fact that *“ECB rates had fallen in the intervening period and the funding ability of Irish Financial institutions had improved significantly.”* [Provider] only contended in their response that their funding does not come solely from ECB borrowing. They have not disputed the fact that the funding ability of Irish Financial institutions had improved significantly during the period in question nor their own funding ability for that matter. Similarly they have not claimed their costs have increased during the period in question to justifying the increase. What they have indicated is that the rates are based on their financial performance. What they have implied, and is evidenced in the Central Bank Ireland report **“Influences on Standard Variable Mortgage Pricing in Ireland”** May 2015, and recognised by the government at the time (additional evidence provided below) was that they are overcharging customers to better their financial performance. The scale of this overcharging is evidenced by the many CBI comparisons with average Variable rates across Europe (the single market) during that period.”

I note that the Complainants have offered their own commentary regarding the essence of this CBI report, advising that:

“While written in a manner that clearly seeks to prioritise financial stability of the system over consumer protection in line with the CBI’s own objectives, the report clearly outlines what is occurring in the market place. It goes on to sound the warning to bank boards that charging spreads that excessively exploit the current weak competitive environment [**i.e. overcharging**] risks being counterproductive if they bring down upon themselves government policy reactions. The piece highlighted the many factors that are involved. The existence of the multiple factors should not be allowed to muddy the water in what is taking place. Nor the fairness of how some of those factors are accounted for in the eye of providing consumer protection.”

I note however that the report in question from the CBI in May 2015, recognises that there are many factors which affect the pricing of a standard variable rate, and indeed those factors identified appear to bear out the position of the Provider:

/Cont’d...

4. Influences on Bank Lending Margins

There are a range of factors that affect the margin that banks charge on variable mortgage rates. These prices will inevitably reflect:

- the cost of funds;
- the credit risk associated with the lending;
- operational costs of running the bank;
- the cost of capital; and
- the market structure and the competitive environment faced by each bank

Any changes in pricing are based on developments in these components. While two of these components have become more favourable for banks, namely the cost of funds relative to crisis peaks and the fact that the market structure has become more concentrated (increasing incumbents' pricing power above what was the case pre-2008 when more competition was present), developments in the other components have been less favourable. Therefore, in terms of any possible scope for banks to reduce their rates on mortgage lending, there may be some flexibility arising from the cost of funds component but less arising from the cost of risk, cost of capital and profitability components. Each of these components is discussed in detail below.⁴

I am satisfied that the FSPO has no role to play regarding the prudential policies of the Central Bank of Ireland, in its capacity as financial regulator. Whilst there may be many arguments to articulate and explore, regarding how financial service providers approach the setting of rates, the issue for determination by the FSPO in this complaint investigation is whether the Provider as the Complainants maintain, acted wrongfully by overcharging the Complainants, in a manner which was not agreed within the terms and conditions of their mortgagee agreement and/or which was in breach of the European Communities (Unfair Terms in Consumer Contracts) Regulations.

In providing the reasons underlying its amendment to interest rates, I accept that the Provider is entitled to retain the particular and commercially sensitive details of how it sets its rates, and that the setting of its variable rates is a matter which falls within the commercial discretion of a Provider.

In assessing the surrounding circumstances as to whether the Provider has acted contrary to good faith, in its setting/application of the relevant variable rates of interest, I note that the information required to be provided, under the Consumer Credit Act 1995, was supplied to the Complainants by the Provider, very clearly within the original loan documentation.

I also find it significant that, save for a brief period, in or about August/September 2015, the variable rate of interest applied by the Provider to the Complainants' loan has been lower than the indicative variable rate, which had been provided for in the Letter of Loan Offer in 2010, of 3.85%. Indeed, when the Complainants submitted their formal complaint to the Provider in February 2016, with reference to the variable rate of interest indicated within the loan documentation, I note that the variable rate of interest applicable to the

Complainants' loan at the time was 3.72% and had reduced to 3.4% when they were issued with the Provider's Final Response letter.

Upon receipt of correspondence of 11 August 2015, 15 September 2015, 19 July 2016, 18 October 2017 notifying the Complainants of a change to the interest rate, I am conscious that they were, upon such notice of a pending change, free to redeem the loan to bring the contract with the Provider to an end, and to switch to an alternative provider, if they so wished. In those circumstances, and on the basis of the foregoing considerations, I do not consider that the Provider has acted either contrary to the terms of the mortgage agreement or in an unfair or unreasonable manner toward the Complainants, in its application of the variable interest rate on the Complainants' loan since the expiry of the fixed rate period of the loan in 2015.

For the reasons explained above, I do not consider it appropriate to uphold the Complainants' complaint that the interest variation clause within the mortgage loan conditions, forming part of the parties' loan agreement, comprises an unfair term for the purpose of the Regulations. As this was the basis upon which the Complainants had asserted that they had been overcharged on their loan account by the Provider, neither do I find any basis which supports the Complainants' contention of overcharging by the Provider in this regard.

Whilst noting the arguments raised by the Complainants concerning the funding ability of Irish financial institutions having improved significantly over the period which is at issue in this complaint, and their position that the Provider's own funding ability has not been disputed by the Provider, or that the Provider has not suggested that its costs have increased over the relevant period, I am conscious that these more recent arguments are somewhat different from the original basis of the complaint which was originally made to this Office's predecessor when the Complainants advised, amongst other things, in the body of their completed Complaint Form that:-

"We knew it was a variable loan and as a result would vary with the cost of funds which are influenced by the ECB rate. We never expected it to track the ECB rate exactly like our previous tracker mortgage nor did we expect that our mortgage provider would try to overcharge us, by amending rates purely at their own discretion. [The provider] have chosen to solve their profitability issues caused by their bad financial decisions not by reducing costs or seeking to write larger volumes of profitable mortgage business but instead they have chosen to unilaterally increase margins on existing business by exploiting the contractual terms of their mortgage contract. In our case they neglected to check if they had that discretion written into our contract. They refute that their actions are contrary to the Unfair Terms in Consumer Contracts Regulations despite the clear ambiguity that exists with no basis actually being included in the agreement such as at their discretion or at their cost of funds or some reference to on the basis of market conditions.

They have knowingly disregarded S.I. No. 27/1995 - European Communities (Unfair Terms in Consumer Contracts) Regulations, 1995, 5(1) In the case of contract where all or certain terms offered to the consumer are in writing the seller or supplier shall ensure that terms are draft in plain, intelligible language. 5(2) Where there is a doubt

/Cont'd...

the meaning of the term the interpretation most favourable to the customer shall prevail. They have since our enquiry offered two potential basis for the movement in rates in their correspondence, none of which are part of our contractual agreement. The basis of change of interest rate is highly relevant. If we had known at the time that this was the approach they would take we would have gone elsewhere or reviewed our decision to purchase. They have quoted from the Regulations that a contractual term shall be regarded as unfair, and consequently unenforceable, if, contrary to the requirements of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer.

It is clear that contractual terms, if interpreted in the way [the Provider] would like, creates a clear imbalance to this parties rights. We would be at the mercy of their discretion to charge us what they like knowing we had little capacity to do anything about it. “

Whilst the Complainants originally maintained that the variation in the variable interest rate was effected by the Provider in a manner which was contrary to the provisions of the European Communities (Unfair Terms in Consumer Contracts) Regulations 1995, as amended, the Complainants now maintain that their complaint requires an examination as to *“the levels of overcharging in the Irish market on variable rate mortgages [which] had got to such a level that it could not be ignored in the Houses of the Oireachtas.”* The Complainants maintain in that regard, that:-

“The exact level of overcharging at any one point in time could only be identified by a detailed analyses of costs of the bank and a review of the margin. Comparison with EU average rates are just indicative but give clear indication of the continued existence of overcharging. Margin can be looked at from two levels. Margin on an individual contract or margin across all products. We would contend that the margin on our individual contract was increased during the period between the time we took out the mortgage (indicative rate 3.85%) and when we actually switched to the variable rate 5 years later (3.97%) as their cost of funds and credit risk had undoubtedly fallen because of improvements in conditions in money market and the wider economy reducing funding costs and credit risk.”

The Complainants suggest that the FSPO has failed to recognise the Provider’s overcharging of the Complainants in respect of their borrowing. They have also taken the view that the FSPO has limited its assessment of fairness, by not acknowledging the overcharging by the Provider, or *“at the very least the higher levels of interest being charged compared with EU averages.”*

The Complainants also maintain that this office has failed to consider the importance of the ultimate ownership of the Provider by the Minister for Finance (the State) and the actions of the State in interfering in the market, guaranteeing the banks, prioritising stability and the re-capitalisation of the Irish banking sector over efficient markets that would have delivered competitive interest rates.” The Complainants also say that this office has likewise ignored the fact that the Minister for Finance has been implicitly accepting the overcharging

/Cont’d...

of standard variable rate customers to avoid having to further capitalise the banks, because it was easier to do rather than raise taxes, cut expenditure or borrow more. The Complainants say that this is evidenced in the news reports they refer to and it continued until overcharging got to such levels that it became politically unsustainable.

The Complainants have also referred to what they consider to be a key development in regulatory regime in the years since they originally raised their initial complaint, in the form of “*the intervention of the CBI in the tracker mortgage scandal.*” They refer to a suggested element of bad faith existing in the Irish banking sector and the shortcomings in customer focus highlighted by a report of the Central Bank of Ireland on Behaviour and Culture of Irish Banks.

In approaching the Complainants’ complaint that they have been overcharged, it is the contractual arrangement in place between the parties which is central. The FSPO will not uphold a complaint because of the perception by one party of “bad faith” and poor culture within the Irish banking sector. The analysis above refers to the provisions of Complainants’ mortgage agreement, and in particular to Mortgage Loan Condition 3.2 which prescribes as follows:-

“The interest rate on the loan may be increased or reduced by [the Provider] from time to time however no change in the interest rate will be applied to the loan during any period when the interest rate is a fixed rate”.

The Complainants contend that the loan agreement entered into with the Provider provides no “basis” for amending the variable rate. This is understood to provide the rationale for the Complainants’ argument that Condition 3.2 falls foul of the European Communities (Unfair Terms in Consumer Contracts) Regulations 1995, as amended. The Complainants maintain that this office ought to have referred the question to the High Court pursuant to **Section 66** of the **Financial Services and Pensions Ombudsman Act 2017**.

This office notes the obligation under EU law, on national courts and other competent authorities in applying domestic law giving effect to a directive, to interpret it, so far as possible, in light of the wording and purpose of the directive concerned, in order to achieve the result sought by that directive. This is known as the doctrine of Harmonious Interpretation.

I am satisfied that the FSPO is a competent authority called upon to investigate mixed questions of law and fact and, in that context, to interpret national law and this Office is therefore bound by the doctrine of harmonious interpretation in its interpretation of the European Communities (Unfair Terms in Consumer Contracts) Regulations 1995, as amended. The FSPO is obliged to consider relevant legislation, case law and the Codes of Conduct published by the Central Bank of Ireland in adjudicating complaints made against regulated financial service providers.

In those circumstances, in the course of the investigation of a complaint, this Office is entitled to, and arguably must, consider the Unfair Terms in Consumer Contracts Regulations when such issues are specifically raised in the course of the adjudication of a complaint. In addition, there is no apparent restriction on the ability of this Office to

/Cont’d...

consider the European Communities (Unfair Terms in Consumer Contracts) Regulations 1995, as amended, and associated case law in determining whether the conduct of a financial service provider has been unreasonable, unjust, oppressive or improperly discriminatory in its application to the Complainant.

In this instance, for the reasons outlined above, this office has taken the view that it would not be appropriate to uphold the Complainants' complaint that they have been overcharged, or that the interest variation clause within the mortgage loan conditions, forming part of the parties' loan agreement, comprises an unfair term for the purpose of the regulations.

Whilst the Complainants have raised a number of regulatory matters relevant to the prudential obligations of financial service providers, I am satisfied that such issues are a matter for the Central Bank of Ireland and do not fall to be considered by this Office.

For the reasons outlined above, this complaint is not upheld.

I note that the Provider has previously offered €400 to the Complainants, in recognition of its customer service failure in not having issued its Final Response Letter to them in accordance with the regulatory timelines provided for under the Consumer Protection Code. I consider this to be an appropriate gesture and if the Complainants wish to accept this offer, they should proceed to liaise directly with the Provider in that respect.

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.



**MARYROSE MCGOVERN
DEPUTY FINANCIAL SERVICES AND PENSIONS OMBUDSMAN**

22 November 2021

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—

/Cont'd...

- (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.**

