

Early termination penalty for premature repayment of a fixed-rate mortgage

Topic: **Fixed-rate mortgage** Case number: **2017/03**

The client sold his property. Since he was required to repay two current mortgages early, the branch of the bank dealing with his case asked him to pay high early termination penalties even though another branch of the same bank was able to grant the purchasers the mortgage necessary for the funding. The client therefore asked the bank for a gesture of goodwill but he found the bank's proposal unsatisfactory. During mediation, the bank withdrew the offer made directly to the client and refused to follow the Ombudsman's recommendation. Once proceedings had ended however, the Bank did offer the client the compensation recommended by the Ombudsman and this offer was accepted.

The client's property was funded by two mortgages. One of these was a fixed-rate mortgage which had been taken out some years previously at a relatively high interest rate compared with current conditions and not due to expire for several years. Personal reasons forced the client to sell his property. With interest rates having fallen in the meantime, the client found himself faced with a high early termination penalty. To calculate this penalty, the bank applied a negative reinvestment rate so that the amount of the early termination penalty was higher than the interest amount the client would have had to pay had the fixed-rate mortgage run its term normally. Given that another branch of the bank granted the purchasers of the property the mortgage required for their funding, the client felt that the bank should have offered a gesture of goodwill in respect of the early termination penalty. The bank then reduced the early termination penalty, which was initially 60,000 CHF, by 5000 CHF. The client deemed this offer unsatisfactory and contacted the Ombudsman.

The client acknowledged his obligation to pay an early termination penalty due to the early repayment of the mortgages he took out. This obligation was provided for in the contracts he signed and these also governed the calculation of the penalty. Under the contract, the client had to pay the difference between the agreed interest rate for the mortgages and the reinvestment rate that could be obtained for the remaining term on the money and capital markets for the capital repaid early. According to the client however, the bank should have taken into account the capital reinvestment made possible by the funding granted to the purchasers. Naturally the latter did not wish to take over the existing mortgages. Instead, they negotiated more favourable interest rates with the bank for the mortgage based on the current market conditions. On the other hand, they raised more funds and the term of their mortgage went beyond that fixed for the client's mortgages. By asking the client to pay the early repayment fee owed due to early repayment of the mortgages, the bank was fully compensated for the interest incurred up to maturity of the aforementioned mortgages. At the same time however, it was able to grant a new mortgage over the same property. Thus, for the remaining term of the client's mortgages, the bank earned interest margins on both mortgages. Furthermore, it did no longer have to bear any risk for the mortgages repaid early. For these various reasons, the client expected the bank to be accommodating and grant him a reduction of around 15,000 to 20,000 CHF in total. After the Ombudsman's intervention, the bank wished to negotiate with the client directly again so the proceedings were initially suspended. During these negotiations, the bank offered the client a further concession of 5000 CHF, in other words a total reduction of the early termination penalty of 10,000 CHF. The client, not satisfied with this offer, contacted the Ombudsman

again.

The Ombudsman advised the bank to offer the client a gesture of goodwill of 15,000 CHF which the bank declared it was not willing to do. It also withdrew the offer it had made to the client directly in view of the fact that the client refused the offer and so the bank no longer felt bound by it. The bank initially stated that the client had concluded a fixed term contract and was, in theory, bound by that agreement. In addition, when calculating the early termination penalty, there was no contractual obligation requiring it to take into consideration the fact that it was able to grant funding to the property's purchasers. Proceeding in this way would mean that the new contract would subsidise the loss of yield suffered due to the early repayment of a fixed-rate mortgage. This would only be different if the purchasers had taken over the vendor's mortgage for the same amount and under the same terms and conditions thereby avoiding an early termination penalty. In this case the parties refused to do this however. The bank further stated that this case did not involve successive funding even though the new funding for the property was only made possible due to the fact that the property was sold and the vendor repaid the mortgages on it early. Early repayment of a fixed-rate mortgage is an exceptional occurrence which unexpectedly deprives the bank of an investment opportunity that was agreed upon. In accordance with the mortgage agreement, the mortgagor must compensate the bank fully if he terminates the contract early. The bank considers that the early repayment forces it to commit the capital to an investment on the capital and money markets which has comparable risks. In fact, according to the bank, the corresponding interest rates for the relevant remaining terms in this case were negative.

The Ombudsman expressed his disappointment in this attitude by the bank. In mediation, he would normally expect a bank to keep open any offers made to a client. That said, the contractual provisions used as a basis for calculating the early termination penalty are common industry practice. With this in mind, one question remains and, to the Ombudsman's knowledge, has not yet been resolved by the judicial authorities: are banks permitted, pursuant to such a clause, to apply negative reinvestment rates? In the case in point, this issue only affects the client to a negligible degree and is not, as such, the subject of the dispute. Nevertheless, given the general circumstances of the matter, greater accommodation on the part of the bank would have seemed appropriate to the Ombudsman. In light of the bank's unyielding position, repeated on multiple occasions, the Ombudsman had no choice but to close the mediation proceedings without success but, to his great surprise, the client informed him shortly after that the bank had contacted him and had eventually decided to offer him a more generous gesture of goodwill. The amount offered at that time matched the Ombudsman's suggestion during mediation. The client accepted this new offer from the bank. During the course of these proceedings, he did however decide to change banks, feeling that the relationship of trust required by a banking relationship was no longer present.