DRN-4616760

The complaint

Mr and Mrs P complain that Pepper (UK) Limited trading as Engage Credit and its predecessors irresponsibly lent to them, subsequently overcharged them on their mortgage by applying an unfairly high rate of interest and have mismanaged the account.

What happened

Mr and Mrs P took out a mortgage with Northern Rock in the summer of 2007, followed by a further advance in November of the same year.

The main mortgage was taken out on an initial fixed rate for two years before reverting to Northern Rock's standard variable rate (SVR) in 2009. The additional borrowing was taken out on a variable rate from inception.

Northern Rock was nationalised in early 2008 and subsequently many of its mortgages were transferred to a new Government-owned successor company known as NRAM.

In 2015, the mortgage was sold to Tulip Mortgages, and administration of the mortgage taken over by Pepper trading as Engage Credit.

The mortgage and further borrowing were redeemed in 2019 when the property was sold.

In September 2020, Mr and Mrs P raised a complaint about how they had been treated by Northern Rock, NRAM, Tulip and Engage.

In respect of Northern Rock, Mr and Mrs P consider it to have lent irresponsibly in 2007 – causing them difficulties with affordability and subsequent attempts to remortgage. They believe the mortgage contracts contained unfair terms and that it was unfair Northern Rock did not disclose its financial difficulties prior to granting the further advance. They also believe NRAM acted unfairly when it chose to sell their mortgage to Tulip Mortgages in 2015 rather than an active and regulated UK mortgage lender.

In respect of Pepper, Mr and Mrs P consider the rate of interest applied to their account to be excessively high and the mortgage terms and conditions that govern their mortgage to be unfair as a matter of law. They've also raised concerns over incorrect information being included in written correspondence in 2019.

One of our investigators reviewed Mr and Mrs P's complaint and thought that, as there are a series of individual complaint points some directed at the predecessors to Pepper and others to Pepper itself (albeit trading as Engage), that the complaint should be split in two with each respondent business responsible for only answering the parts of Mr and Mrs P's complaint that took place when it was the owner of the debt.

She also set out to Mr and Mrs P that parts of their complaint had been brought too late under the rules that our service must apply. As a result, she would not be able to consider or comment on some of the complaint points raised.

Having defined the scope of the complaint for each respondent business and identified which parts of the complaint had been brought in time, the investigator went on to issue her assessment to the parties, ultimately not upholding the complaint against either NRAM or Pepper.

Mr and Mrs P disagreed with the investigator's findings on both the application of our jurisdiction and the merits of the part of the complaint that has been brought in time. They also suggested the complaint ought to be dealt with as one complaint or at the very least, dealt with together to provide the necessary context from the series of events that started in 2007 with Northern Rock and ran through to the mortgage redemption in 2019.

As the complaint could not be resolved informally, it has been passed to me to decide.

In reviewing the two complaints I could see that Pepper (trading as Engage Credit) had told our service that it was responsible for answering complaints that were made after the date it became responsible for the debt – even if the events complained of took place prior to the date of transfer. As Pepper took on Mr and Mrs P's debt in 2015 and the complaint was not made until 2019, this would mean it is responsible for answering all the complaint points raised by Mr and Mrs P, even though some of the events complained of, took place while the debt was with NRAM and its predecessor, Northern Rock.

Considering this, I asked the investigator to notify Engage that we would be merging the two complaints into one and asked whether it consented to this service considering the events that took place more than six years ago. Engage responded to say it did not consent to us considering complaint points about events that have been brought out of time.

As Mr and Mrs P didn't accept our investigator's application of our jurisdiction rules, I issued a decision setting out the extent of our powers to consider the complaint. In summary I said the following complaint points had been brought too late and therefore fall outside the scope of the Financial Ombudsman Service:

- Mr and Mrs P's complaint that Northern Rock irresponsibly lent to them in 2007 and did not disclose its financial standing when doing so.

- Their complaint that their mortgage contracts contained an ERC which led to them being treated unfairly; and

- Their complaint about the fairness of the rate of interest charged between 2007 and 23 September 2014.

I set out that I could consider the following points as they occurred within six years of the date of the complaint:

- NRAM's decision to transfer the mortgage to Tulip in 2015

- The fairness of the interest rate charged between 23 September 2014 and when they redeemed their mortgage in 2019; and

- The incorrect information provided by Engage in 2019.

As I have set out the application of the rules governing our jurisdiction to Mr and Mrs P's complaint and Engage has been provided with an opportunity to comment on the full breadth of the case, I will now go on to consider the merits of the parts of the complaint that have been brought in time.

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.

When considering what is fair and reasonable in all the circumstances, I am required by DISP 3.6.4R of the Financial Conduct Authority's (FCA) Handbook to take into account:

'(1) relevant:

(a) Law and regulations;

(b) Regulators' rules, guidance and standards;

(c) Codes of practice; and

(2) (where appropriate) what [I consider] to have been good industry practice at the relevant time.'

I also focus on what I think is material and relevant to reach a fair and reasonable outcome. So, although I have read everything that has been supplied to me, I may not address every point that has been raised.

Having done all that, I don't think this complaint should be upheld. I realise this will be disappointing for Mr and Mrs P. But I hope the reasons I have set out below will help them to understand why I have come to this conclusion.

<u>NRAM's decision to transfer the account to Tulip</u>

NRAM transferred Mr and Mrs P's mortgage to Tulip in 2015. NRAM's ability to transfer the mortgage accounts is set out in the terms and conditions of the mortgage agreements Mr and Mrs P agreed to in 2007. So, I must find that in transferring the accounts, NRAM was exercising a contractual right under the contract and as such, this would not lead me to automatically uphold the complaint.

Mr and Mrs P say it is unfair that their account was transferred to an unregulated body which does not provide new interest rates or lending to consumers. I can appreciate their strength of feeling on this point and I accept that had they been moved to an active lender, they may have had more options available to them without needing to either redeem the mortgage or take their borrowing to a new lender.

However, while I can appreciate why Mr and Mrs P feel the way they do, NRAM didn't act in error or unfairly in transferring the debt to Tulip. It was entitled to do so under the contracts in question and the accounts are administered by a UK regulated administrator who is required to act in line with FCA rules and guidance. So, I do not agree that this transfer has led to Mr and Mrs P suffering a financial loss or being otherwise treated unfairly.

<u>Management of the mortgage account</u>

Mr and Mrs P believe Pepper to have mismanaged their mortgage account by not applying interest in line with the terms and conditions of their account. They consider this to be compounded by Pepper sending inaccurate letters detailing the interest rate applicable to their account.

I shall start with the letters. It is not in dispute that the letter dated 6 September 2019 was inaccurate. And I can understand that such a mistake could cause Mr and Mrs P to question how Pepper was running their account. However, I can also see that a correction was issued on 19 September 2019 clarifying the position.

While I acknowledge and accept the inconvenience and doubt the inaccurate letter caused, I am satisfied Pepper corrected the information promptly. And I am not persuaded it needs to do anything further on this point.

And while Mr and Mrs P have told this service that they have concerns as to whether Pepper has applied interest to their account in line with the mortgage terms and conditions, I have not seen any evidence to suggest they raised this point with Pepper directly before referring the complaint to our service. As a result, it would not be appropriate for me to comment on this point in my decision. A respondent business must be given the opportunity to investigate a complaint before it is referred to our service.

<u>The rate of interest charged</u>

The fairness of the interest charged

Mr and Mrs P say the interest applied to their mortgage account while they were on the SVR was extortionate and unlawful. They've subsequently added that the rate charged by Engage since it took over the debt is unfair as the underlying contract contained unfair SVR terms, so going on to profit from such terms seems unjust.

The first place to start when considering the interest applied to Mr and Mrs P's mortgage is the terms and conditions of the borrowing they took out with Northern Rock. This forms the contract within which Northern Rock agreed to lend (and on what terms) and Mr and Mrs P agreed to repay the sums in question.

Mr and Mrs P took their mortgage and further borrowing with Northern Rock in quick succession – both form part of this decision.

Section 4 of the mortgage offer issued in June 2007 states:

"4. Description of this mortgage

This is a Northern Rock product: 2 Year Flexi Fixed 1995 Prod Fee

This secured mortgage is based on the following interest rate products

- *a fixed rate of 4.95% until 1 March 2009*

  followed by

- *the Northern Rock Standard Variable Rate, currently 7.59% for a period of 5 years and 7 months*

  followed by

- *Northern Rock's Variable Loyalty Discount Rate, which is Northern Rock's Standard Variable Rate, currently 7.59% with a discount of at least 0.25% which will apply, provided that payments are kept up to date for the remainder of the mortgage giving a current rate payable of 7.34%*

  …"

And the offer for the further advance issued in November 2007 sets out:

*"**4. Description of this additional borrowing***

This is a Northern Rock product

This is a Flexible Variable Rate PSL product

This secured mortgage is based on the following interest rate periods:

- *A variable rate which is 1.00% above the Northern Rock Standard Variable Rate, currently 7.84% for the entire life of this secured loan, to give a current rate payable of 8.84%*

  …"

So, it was clear from the outset that Mr and Mrs P's first charge mortgage would revert to Northern Rock's SVR after 1 March 2009. And that their further borrowing was on a variable from the start. This documentation also set out what the SVR was at the time of the advances and notified Mr and Mrs P that the interest rate on their mortgage could go up as well as down.

Section 7 of the general mortgage terms and conditions that apply to Mr and Mrs P's mortgage set out how the variable rate can be changed.

Mr P and Mrs P say the SVR terms amount to unfair terms. Legally, the effect of a term being unfair as a matter of law, is that it won't apply. But the presence of a potentially unfair term does not necessarily mean there has been an unfairness such that I automatically uphold the complaint. Under our rules I am required to consider what is fair and reasonable in all the circumstances. That includes – but is not limited to – relevant law.

So, while I have taken account of the relevant law regarding unfair contract terms, I've also thought more broadly about whether the *way* the terms have been used has resulted in Mr and Mrs P being treated unfairly.

In answering this question, I am doing so in the context that this complaint only concerns the fairness of the interest charged to Mr and Mrs P's mortgage since 23 September 2014. All interest charging points before that are out of time because Mr and Mrs P did not refer their complaint in time.

However, in order to consider the fairness of the interest Mr and Mrs P were charged during the period that is in time, it is necessary for me to consider historic changes to NRAM's SVR, since the SVR charged during the period of time that is in time is the result not only of decisions NRAM made during that period, but also the result of decisions made prior to it.

Having established that I need to look at the SVR both before and after 23 September 2014, and having considered all the available evidence, I am not persuaded Mr and Mrs P's rate has been varied unfairly or that they have been treated unfairly by virtue of the SVR term. I have set out why below.

While on the SVR Mr and Mrs P would've been free to move to a different lender without paying an early repayment charge (ERC) should they have become dissatisfied with the rate they were being charged.

I appreciate Mr and Mrs P have said there were practical barriers to them being able to move, namely the lack of available equity in their property and the tighter lending rules in 2014, this does not mean the SVR they were charged was unfair or in some way unlawful.

Mr and Mrs P have pointed to the rates charged by other lenders at the time as an example of why they think the rate they were being charged was unfair.

This service approached NRAM and asked it to provide information and evidence to support its decision to vary (or not vary) its SVR from 2005 to 2022 – and as this period covers the time of Mr and Mrs P's mortgage, the information it provided is applicable to this case until the mortgage was transferred in 2015.

The information provided by NRAM is confidential and our rules allow us to accept such information in confidence should we consider it appropriate to do so – which I consider to be the case here. As such, copies of the information supplied by NRAM (and the subsequent lenders) has not been provided to Mr and Mrs P other than the summary set out in this decision.

Between 2007 (when Mr and Mrs P applied for their first charge mortgage) and 2009, the SVR only reduced. But the difference between the SVR and the Bank of England base rate increased from 2.09% to 4.29%

Neither of Mr and Mrs P's mortgages were tracker mortgages, so NRAM was not contractually obligated to have its SVR track base rate. Nor is it the case that Mr and Mrs P's mortgage had a cap preventing NRAM's SVR from increasing beyond a certain 'margin' above base rate. In addition, I don't think a term allowing NRAM to reduce the SVR, and with it, the amount Mr and Mrs P had to pay, is likely to be unfair in principle as a matter of law.

During this time, the mortgage market was going through a period of significant change as a result of the global financial crisis. This impacted the funding costs of businesses and was reflected in changes to a number of lenders' interest rates charged across the market at the time. This was clear at the time and has been subject of analysis by both the Bank of England and the FCA since.

Whilst the base rate did reduce significantly during this period, the cost to lenders of funding their businesses changed, as did their prudential requirements. These were made up of several factors that are not directly linked to base rate. There was a substantial risk to all lenders during this period and they all had to find ways to mitigate that risk while balancing the need to treat customers fairly.

NRAM has told us that, like many lenders at the time, it was predominantly funded by wholesale funding. The cost of which was in the most part, contractually defined by reference to LIBOR and LIBOR generally followed base rate prior to the financial crisis. As a result, changes in base rate tended to result in changes to cost of funding. Before the financial crisis, changes in costs of its retail funding also tended to correspond to changes in base rate.

However, during the financial crisis, there was a significant dislocation between LIBOR and base rate, such that reductions in base rate were not matched by commensurate reductions to LIBOR or to NRAM's cost of wholesale funding. In addition, access to wholesale funding became harder to come by as lenders became more concerned at the risk of default – NRAM in particular has shown how its credit rating was impacted and the implications this had on its ability to raise, and the cost of, its funding. It also experienced an outflow of its retail saving deposits following negative press in late 2007.

To avoid collapse, NRAM received State Aid in the form of a Government loan in September

2007. With the aid, came several conditions on how NRAM could operate and obligations on how and when it should look to repay the loan. Understandably, this significantly impacted its commercial strategy and with it, the cost of funding mortgages like Mr and Mrs P's. To add to this, NRAM was nationalised in February 2008 with its entire share capital being transferred to HM Treasury.

So, in summary, while NRAM did not pass on the full reductions in base rate to its customers, given it had passed on some reductions and taking into account the documented increase in cost of funding across the industry, and the obligations surrounding the Government loan, I am satisfied NRAM balanced its own financial position and obligations at the time with the impact such changes would have on customers like Mr and Mrs P.

And while NRAM's SVR was at the higher end of what was being charged across the industry at the time, it was not an outlier, with several lenders charging higher SVRs. While the SVR charged by other lenders is not directly relevant to NRAM's cost of funds, these factors reassure me in my conclusion that NRAM's decision on how much to reduce its SVR by were proportionate to the costs it – along with the rest of the industry – faced at this time and not unfair.

After 2010 and before the transfer of Mr and Mrs P's mortgage in 2015, the only changes made to the SVR were in line with changes made to the base rate. And NRAM has shown the SVR was continually reviewed, with it having regard to the changes made by other lenders and its continuing obligations under the Government loan.

Following the transfer of Mr and Mrs P's mortgages to Pepper in 2015, the SVR applicable to their accounts has followed the movements in base rate.

Taking all of this into account, I am not persuaded the SVR term in Mr and Mrs P's mortgage contracts led to them being treated unfairly or that NRAM and subsequently Pepper (trading as Engage) have applied an unfair rate of interest. Instead, I am satisfied both NRAM and Pepper have varied the SVR in line with the terms and conditions and have exercised those terms fairly.

My final decision

For the reasons set out above, I do not uphold this complaint and I make no award against Pepper (UK) Limited trading as Engage Credit.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr P and Mrs P to accept or reject my decision before 27 March 2024.

Lucy Wilson
Ombudsman