

The complaint

Mr S complains that Pepper (UK) Limited trading as Engage Credit changed his mortgage from capital repayment to interest only. He also complains that the interest rate on the mortgage is much higher than it should be.

What happened

Mr S took out a mortgage with Northern Rock in 2007 on an interest only basis across an original term of 25 years.

The interest rate on the mortgage was fixed from inception in 2007 to 1 March 2012 when it reverted to Northern Rock's discounted variable rate. The mortgage has remained on this rate since 2012.

During the 2008 financial crisis, Northern Rock was nationalised to avoid collapse of the bank. NRAM was later formed to manage most of the remaining Northern Rock mortgages, which included Mr S' mortgage. In 2015, Mr S' account was transferred from NRAM to Engage Credit – no other changes were made to the mortgage at this time.

In early 2023, Mr S complained to Engage Credit. He was unhappy that his mortgage was on interest only terms and believes he originally took out a capital repayment mortgage. He also said the interest rate he was paying was excessive.

Engage Credit responded to say it had reviewed the transfer documents from NRAM and could confirm that the evidence it had on file showed the mortgage had always been on interest only terms. It went on to explain that Mr S' mortgage was on a variable rate which had been impacted by wider increases to market rates and as such, it had increased. It explained the interest rate increases were carried out correctly on Mr S' account.

Dissatisfied with Engage Credit's response, Mr S referred his complaint to this Service.

I issued a provisional decision not upholding this complaint earlier this month. In summary, I was satisfied that Mr S had taken out an interest only mortgage in 2007 and at no point had it become a capital repayment mortgage. I also set out that from the evidence I had seen, the interest rate on his mortgage had varied in line with the mortgage terms and conditions and those terms had been exercised fairly. I invited both parties to provide any further comments or evidence they wanted me to consider before I issued my final decision.

Mr S told us he had no further comments to make and would await the final decision.

Engage Credit confirmed it accepted my provisional decision and made no further representations.

As the deadline to respond has now passed it is appropriate for me to move to final decision on this complaint.

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.

Engage Credit has told us that it consents to this Service considering Mr S' complaint even though the events complained of took place more than six years ago. So, I am satisfied I have the power to consider this complaint.

Mr S' core complaint relates to whether Engage Credit incorrectly changed his mortgage to interest only from capital repayment when it took over the account in 2015.

I set out in my provisional decision that the original mortgage offer signed by Mr S in 2007 set out that he was agreeing to take out a mortgage on interest only terms. And there is no other evidence to suggest the mortgage was changed to capital repayment after this date, either before or after the transfer to Engage Credit.

As neither party have provided any further comments on this point, I see no reason to depart from my provisional conclusions. So, it follows, that I do not uphold this element of Mr S' complaint. His mortgage has operated on the same repayment basis as the one he agreed to originally in 2007 and has not been varied incorrectly. Should Mr S be concerned as to how he will repay the capital balance at the end of the term, I would urge him to speak to Engage Credit at his earliest convenience.

Mr S also complains that the rate of interest he is being charged is too high and hasn't tracked falls in wider market rates.

I set out in my provisional decision that Mr S' mortgage is not a tracker rate and therefore Engage Credit and its predecessors were under no contractual obligation to ensure Mr S' mortgage tracked the Bank of England base rate or any other reference rate.

Instead Engage Credit and its predecessors had to ensure that if it chose to vary Mr S' interest rate, it did so fairly and in accordance with the relevant mortgage terms and conditions.

In determining whether Engage Credit and its predecessors had exercised the terms and conditions fairly, I explained I had looked at the changes to Mr S' rate since inception, including the time he was on a fixed interest rate. As a Service we had also asked NRAM to explain and provide evidence for the variations it made to its SVR across the period in question.

During the first few years of Mr S' mortgage, the mortgage market was going through a period of significant change because of the global financial crisis. This impacted funding costs of businesses and was reflected in changes to several lenders' interest rates charged across the market at the time. 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 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, Northern Rock 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 Northern Rock'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 Northern Rock's 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 2007.

To avoid collapse, Northern Rock received State Aid in the form of a Government loan in September 2007. With the aid, came several conditions on how it 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 S'. To add to this, Northern Rock was nationalised in February 2008 with its entire share capital being transferred to HM Treasury. One of the conditions of the restructure was that Northern Rock would be limited to a maximum of a 1.5% share of all retail funding in the UK and 0.8% in Ireland.

In addition, as part of its restructure, it was agreed it would transfer all its higher quality assets to a third party, whilst the lower quality assets would remain with NRAM and be wound down. Given the perceived quality of these assets, this had a further impact on the cost of Northern Rock's funding.

In light of this, NRAM and its predecessor Northern Rock, reduced its variable rate on several occasions, just not by the same proportion as base rate. Given the documented increase in cost of funding across the industry, including for Northern Rock specifically, and the obligations surrounding the Government loan, I am satisfied Northern Rock balanced its own financial position and obligations at the time with the impact such changes would have on customers like Mr S.

And while Northern Rock and later NRAM's variable rate 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 a higher variable rate. While the SVR charged by other lenders is not directly relevant to Northern Rock's cost of funds, these factors reassure me in my conclusion that Northern Rock and later NRAM's decisions on how much to reduce the variable rate by were proportionate to the costs it – along with the rest of the industry – faced at this time and not unfair.

Between 2010 and 2019, most of the changes made to Mr S' variable rate were either in line with changes to the Bank of England base rate or with a small variation – despite it not being obligated to track this rate. These changes were permitted under the terms of the contract, and I'm satisfied they were reasonable.

A variation was made to the rate in 2019 due to fluctuations in LIBOR – a reference rate which at the time, impacted the cost of funding mortgages like Mr S'. This was permitted by the terms and conditions of Mr S' mortgage and I'm satisfied it was applied fairly given the circumstances.

Since 2020, the way Mr S' mortgage is funded has changed and it has begun to track the Bank of England base rate. As such, each variation to Mr S' mortgage has mirrored the changes to the Bank of England base rate and was permitted by the terms and conditions.

In light of this, I am satisfied that the rate of interest Mr S has been charged over the lifetime of his mortgage has been in line with the mortgage offer he agreed to in 2007. The interest rate has been varied in accordance with the relevant mortgage terms and conditions and

those terms have been applied fairly given the wider context within which the changes have been made.

I appreciate Mr S feels as though the rate is excessive and that others are paying less in interest on their mortgage. As Mr S is on the variable rate, he is able to move his mortgage elsewhere without incurring an early repayment charge or any other significant financial barrier from Engage Credit. While I appreciate there may be other reasons why Mr S has either chosen to remain on the variable rate or has been unable to switch to a new lender, this isn't something I can hold Engage Credit responsible for.

My final decision

For the reasons detailed, I do not uphold Mr S' complaint about Pepper (UK) Limited trading as Engage Credit.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr S to accept or reject my decision before 29 October 2024.

Lucy Wilson
Ombudsman