

The complaint

Mr and Mrs H's complaint is about a second charge mortgage they had with UK Mortgage Lending Ltd trading as Pepper Money. They believe that Pepper Money's decision to lend was irresponsible as the mortgage was not affordable and their credit rating was very low at the time. In addition, Mr and Mrs H don't believe that the advice to consolidate unsecured debts into a secured mortgage was right. They say this led to them having to sell their home.

What happened

In 2018 Mr and Mrs H took advice from an independent mortgage broker. They were recommended to take out a second charge mortgage of £49,590, including fees, with Pepper Money on a repayment basis over a term of 24 years.

Before deciding whether to accept the application, Pepper Money completed an assessment of Mr and Mrs H's finances to establish if they could afford the mortgage they had applied for. It asked them to provide payslips, details of their existing debts and information about their normal expenditure. Pepper Money also obtained information about Mr and Mrs H's credit files.

At the time of the application Mr and Mrs H had a mortgage, six credit cards and two loans. Their loans and credit cards totalled just under £44,000 and just under £43,000 of the debts were to be repaid. This would leave them around £1,000 on three credit cards after the mortgage was advanced.

Pepper Money asked Mr H for payslips to evidence his income and Mrs H for tax return information for 2016 and 2017. From these documents it worked out a net monthly income of just over £3,300 per month. Mr and Mrs H's broker also provided information about their outgoings. Pepper Money has confirmed that when working out their standard monthly outgoings, not including debts or the mortgage, its usual approach would be to use the higher of the figures that Mr and Mrs H provided and Office of National Statistics' (ONS) figures for a typical household of the nature of theirs. This would have produced a figure of £1,321.99 for outgoings, taking a slightly lower amount than the ONS figure for utilities, as Mr and Mrs H had evidenced those costs. However, the affordability assessment Pepper Money has provided us with from 2018 shows that Pepper Money used a figure of 1,037.32 for Mr and Mrs H's outgoings, which is the amount they declared to the broker for their outgoings.

In addition, Pepper Money built into its affordability assessment a "stress test", as it is required to do where either or both parts of the mortgage might be subject to a change in interest rates within five years. This involves adding a sum to the affordability assessment assuming the interest rate increases by an assumed amount. In this case Pepper Money assumed a 2% interest rate increase.

The affordability assessment Pepper Money gave us details of set out:

Net income	£3314.62
------------	----------

1st charge mortgage	£1250
2nd charge mortgage	£455
Unconsolidated debt	£41.22
Less expenditure	£1037.32
Stress test	£298.27
Disposable income	£232.81

Mr and Mrs H maintained the monthly payments to the mortgage until the spring of 2020, when a six-month Covid-19 payment deferral was added to the mortgage. They then returned to paying the mortgage on a monthly basis, but they struggled at times after this to pay the mortgage until March 2022. Their circumstances then improved, and they started to repay the arrears that had built up on the mortgage.

The mortgage was repaid in April 2023. Mr and Mrs H raised a complaint about the lending decision in 2018 and said that this had led them to needing to sell their home.

Pepper Money responded to the complaint in a letter of 17 May 2024. It explained the process it had gone through and the checks it had made before the decision to lend was made. Pepper Money said it was satisfied that the mortgage was affordable at the time and had been lent responsibly.

Mr and Mrs H were not satisfied with Pepper Money's response and asked this Service to consider the complaint. One of our Investigators did so and recommended that the complaint be upheld. She noted that Pepper Money had made two errors in the affordability checks it completed before agreeing to lend to Mr and Mrs H. One was that when it stress-tested the existing and new mortgages, as it was required to do, it used a lower percentage in its calculations than was recommended at the time. The second error was that it had not used the correct figure for Mr and Mrs H's normal outgoings, which meant that even with the stress test calculated using the lower percentage, the mortgage was unaffordable.

Pepper Money did not accept the Investigator's conclusions. It focussed on the comments the Investigator had made about the stress test having been completed using a lower percentage than was recommended at the time. In relation to Mr and Mrs H's income and expenditure, it said that Mrs H's income evidenced from her business bank statements had been higher than it had used in its assessment. It said that at no point until their complaint had Mr and Mrs H said the mortgage was unaffordable and they hadn't had any payment issues until their income had been impacted by the Covid-19 pandemic. Pepper Money also said that if the child benefit Mrs H received had been built into the affordability assessment, using a stress test based on the 2%, the mortgage was affordable and sustainable over its term.

The Investigator considered what Pepper Money said, but she was not persuaded to change her conclusions. Pepper Money put in further submissions regarding the stress test it had applied and asked that the complaint be referred to an Ombudsman.

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.

In 2018, when the mortgage was taken out, it was covered by the rules of mortgage regulation, which can be found in the MCOB section of the Financial Conduct Authority's Handbook.

The rules require a lender to assess affordability and not lend unless a loan is affordable. In making the assessment a lender must obtain evidence of income, and information about expenditure. It can assess expenditure based either on a borrower's actual declared outgoings, or it can use modelled expenditure information - such as typical expenditure figures for a household of the consumer's type – for living expenses. However, it must always use actual figures for committed expenditure, such as other credit agreements. The rules also say that a lender is entitled to rely on what it's told about expenditure, unless, taking a common-sense view, it has reason to doubt it.

Pepper Money provided its affordability assessment completed in 2018 when the mortgage was agreed. It is clear that the figure for expenditure it used was not the one that it should have, based on the standard approach it has explained to this Service. The figure it used was approximately £285 lower than it should have been. Even using the figure it did for the stress test, this produces a negative figure. So had the correct expenditure figure been used, Pepper Money's standard affordability check would have failed and determined the mortgage was unaffordable.

In its response to the Investigator's view, Pepper Money has highlighted that when it did the affordability assessment, it did not take into account the child benefit Mr and Mrs H received, or that Mrs H's bank statements showed that her income was slightly higher than the figure calculated using her tax return data. It has said that if the child benefit or the higher income for Mrs H was factored in, the affordability assessment would have passed even using the correct expenditure figure.

It is entirely plausible that Mrs H's income for the year in which the mortgage was granted was higher than it had been in previous years. However, given the unpredictability of self-employment and the income fluctuations that tend to accompany it, it was equally plausible that her income would not have been higher. This is why a lender will have an approach for how it calculates the amount of income that it will use in its affordability assessments. Pepper Money followed its normal approach in this case for determining Mrs H's income and I do not consider that it is now appropriate for it to suggest that figure should have been different, simply because it has been pointed out that the affordability assessment would have failed.

I would say the same about the matter of the child benefit it raised too. While Mr and Mrs H did receive child benefit, like many lenders, Pepper Money chose not to take that income into account in the affordability assessment. I assume this is because it's not a long-term guaranteed income, as it is dependent on the age of the child and, when considering a 24-year term mortgage, is guaranteed to stop being paid before the end of the term. I don't consider that was an unreasonable approach to this benefit.

Pepper Money highlighted that Mr H was paying £160 into a pension scheme, which it could have ignored for the purposes of calculating his net income. Pepper Money is correct that it is able to ignore non-committed expenditure. However, if it wanted to do this with Mr H's pension contributions, it would have needed to investigate the contributions and his pensions scheme further. If ignoring pension contributions was the deciding factor in making a mortgage affordable to a borrower, the borrower would need to be told that was the case.

Mr H was in his early forties at the time of the mortgage application – a key time to make provision for retirement and, should he have stopped his pension contributions, even for a short time, it is unlikely he would have been able to make up the shortfall that would create. Furthermore, if he were to leave his occupational pensions scheme, it is not always possible for a member to rejoin. As such, I think with the limited information Pepper Money had about the pension scheme and Mr H's membership of it, it made the right decision not to ignore this expenditure when it calculated his net income for the purposes of its affordability assessment.

Pepper Money had an approach to how it determined income to be used in the affordability assessment at the time it accepted Mr and Mrs H's application. I have to assess this complaint based on that approach. While Pepper Money has now said that it could have found ways of boosting Mrs H's income to change the outcome of the affordability assessment from a failure to a pass, that's something it has said with hindsight. As is always the case, I can't take hindsight into account when determining a complaint. I am satisfied that, had Pepper Money completed its standard affordability assessment using the correct expenditure figure, the affordability assessment would have failed as it would have produced a negative disposable income, even using a lower figure for the stress test than usual.

I now move on to the matter of the stress test that was factored into the affordability assessment. As I have said above, the standard affordability assessment would have shown that Mr and Mrs H could not afford the mortgage, even using the stress test used. At the time of the application, the stress test that was recommended by the FPC was 3%. While MCOB allows a lender to decide what interest rates will likely be in the future for the purposes of carrying out a stress test, it has to have regard to:

- a) Market expectation; and
- b) The prevailing FPC recommendation on appropriate interest rate stress tests.

Pepper Money has provided an explanation of why it used 2% rather than the 3% that FPC recommended. The reporting that it has relied on for the majority of its explanation was produced after Mr and Mrs H's mortgage was sold, and so I am not persuaded that it was reasonable for Pepper Money to use a lower percentage in its stress test than the FPC recommendation. However, I don't consider this matter is key to the outcome of this complaint, as even at the lower stress test used, using the correct expenditure figure, the mortgage was unaffordable and all that using a 3% stress test would have done would have made it more unaffordable.

Overall, for the reasons set out above, I do not consider that Pepper Money should have lent to Mr and Mrs H in 2018.

My role is to put Mr and Mrs H back in the position they would have been in had this lending decision not been made. As such, I consider that Pepper Money should calculate how much Mr and Mrs H would have needed to pay in April 2023 to redeem the mortgage, assuming that no interest, fees or charges were applied, including those associated with setting up the mortgage and exit fees. It should then pay Mr and Mrs H the difference between that figure and the amount they paid in April 2023, plus interest.

Although the broker fee was not charged by Pepper Money and it received no benefit from the fee, it was added to the mortgage debt. However, if Pepper Money hadn't lent to Mr and Mrs H then they wouldn't have incurred that broker fee, so the fact they owed that sum on this loan is directly attributable to the lending decision made by Pepper Money.

I don't think it would be fair to ask Pepper Money to write off the remaining capital balance or to refund the payments made towards that capital. Mr and Mrs H used the majority of the

capital to pay off other debts, so it's fair and reasonable that they pay back what they borrowed. However, I don't consider it's fair and reasonable for Pepper Money to charge fees and interest for a loan it should not have entered into.

It is possible Mr and Mrs H would have come to some arrangement with their unsecured creditors had this mortgage not existed. So it's not possible to be sure exactly what capital or interest they would have had to pay if the debts had not been consolidated into this loan.

It's likely that removing all interest from this loan results in a saving to Mr and Mrs H compared to the amount they would have had to pay towards the consolidated debts had they not been consolidated. It's also entirely possible they would have entered an arrangement such as an IVA or bankruptcy which would have led to them paying less (although with other consequences).

Although the existence of this mortgage caused Mr and Mrs H distress and inconvenience, with the added worry that it was secured over their property, I don't propose to compensate them separately for the distress and inconvenience this lending and the associated financial difficulties caused them. I think the saving made in writing off the interest on this loan, compared to what Mr and Mrs H would likely have had to pay had the debts not been consolidated, represents fair compensation for that.

Putting things right

Pepper Money should:

- A. Recalculate the redemption figure on the basis that no interest or fees, including the broker, set-up and exit fees, were charged.
- B. Pay Mr and Mrs H the difference between the recalculated redemption figure and the amount they paid to repay the mortgage in April 2023.
- C. Add interest* should to the figure refunded at B from the date the mortgage was repaid to the date of settlement.
- D. Remove any adverse information reported on Mr and Mrs H's credit files regarding the mortgage.

*Interest is at a rate of 8% simple per year and paid on the amount specified and from/to the dates stated. If Pepper Money considers that it's required by HM Revenue & Customs to deduct income tax from any interest due to Mr and Mrs H, it should tell them how much it's taken off. It should also give them appropriate documentation for use with HM Revenue & Customs if appropriate.

My final decision

My final decision is that I uphold this complaint. I require UK Mortgage Lending Ltd trading as Pepper Money to settle the complaint as detailed above in 'Putting things right'.

Under the rules of the Financial Ombudsman Service, I am required to ask Mr and Mrs H to accept or reject my decision before 9 January 2026.

Derry Baxter
Ombudsman