

The complaint

Mr M complains that UK Mortgage Lending Ltd trading as Pepper Money gave him a secured second charge loan without carrying out appropriate affordability checks.

What happened

In October 2019 a third party broker recommended that Mr M should take out a second charge loan. Mr M accepted that advice and took a loan with Optimum Credit for £35,147 repayable over 24 years with an interest rate of 11.353% fixed for two years. A lender fee of £595 and an advice fee of £995 were added to the loan. The purpose of the loan was to repay unsecured debt. Mr M repaid the loan in November 2024.

Optimum Credit was the previous registered name of UK Mortgage Lending Ltd trading as Pepper Money, but I will refer to Pepper Money throughout this decision.

Mr M's complaint is brought by a representative. They said that Pepper Money did not carry out appropriate checks as required under the Consumer Credit Sourcebook (CONC) and as a result has lent to Mr M irresponsibly.

I issued a provisional decision proposing to uphold the complaint. My provisional findings, which form part of this decision, were:

The second charge loan Mr M took with Pepper Money was a regulated mortgage contract. It is not clear why his representative thought that CONC was relevant here. MCOB is the relevant rules. They required Pepper Money to lend responsibly, take full account of Mr M's net income, his committed expenditure, and the basic essential expenditure and basic quality-of-living costs of his household.

MCOB said at the relevant time that lenders should consider the impact of future interest rate rises:

"MCOB 11.6.18R

(1) Under MCOB 11.6.5R (4), in taking account of likely future interest rate increases for the purposes of its assessment of whether the customer will be able to pay the sums due, a mortgage lender must consider the likely future interest rates over a minimum period of five years from the expected start of the term of the regulated mortgage contract (or variation), unless the interest rate under the regulated mortgage contract is fixed for a period of five years or more from that time, or for the duration of the regulated mortgage contract (or variation), if less than five years.

(2) In coming to a view as to likely future interest rates, a mortgage lender must have regard to:

(a) market expectations; and

(b) any prevailing Financial Policy Committee recommendation on appropriate interest-rate stress tests;

and must be able to justify the basis it uses by reference to (a) and (b).

(3) For the purposes of this rule, even if the basis used by the mortgage lender in (2) indicates that interest rates are likely to fall, or to rise by less than 1%, during the first five years of the regulated mortgage contract (or variation), a mortgage lender must assume that interest rates will rise by a minimum of 1% over that period.

MCOB 11.6.18AR

(1) Under MCOB 11.6.5R (4), in taking account of likely future interest rate increases for the purposes of its assessment of whether the customer will be able to pay the sums due, a second charge lender must also consider the likely future interest rates of any regulated mortgage contract in existence at the time of the assessment and remaining in existence after the relevant second charge regulated mortgage contract has been entered into.

(2) The second charge lender must, at a minimum, base its assessment under (1) on the balance outstanding of any regulated mortgage contract relevant under (1).

MCOB 11.6.19G

In relation to MCOB 11.6.18R (2):

(1) an example of market expectations is the forward sterling rate published on the Bank of England website. A mortgage lender should not use its own forecast; and

(2) a mortgage lender should not link its determination to market expectations without considering the likely effect of rate changes in accordance with the market expectations on the specific regulated mortgage contract in question.”

Income and expenditure

Pepper Money recorded Mr M's total monthly net income as £2,917.92 – made up of £1,792.19 income from employment, £1,030.03 in disability living allowance (DLA) and an industrial injuries disability benefit, and £89.70 in child benefit.

Pepper Money had proof of Mr M's income from employment and it was reasonable to accept the figure it did.

I don't agree that it was unfair for Pepper Money to accept Mr M's income from benefits. It would be unfair for it to discriminate against him because that was the source of some of his income. In many cases benefit income is no less secure than that derived from employment. In this case I am satisfied that Pepper Money had sufficient reason to accept the income from the industrial injuries disability benefit. The evidence it had said that was a lifetime award for Mr M.

The income from the DLA was not guaranteed. It could be stopped or changed. The letter Pepper Money had showing Mr M's income from DLA also set out it was being replaced by the personal independence payment (PIP). But I can't see that Pepper explored Mr M's circumstances in more detail to understand whether it was likely that he would continue to receive the DLA or PIP. But I think if it had, then it is likely that Mr M would have been able to satisfy Pepper Money that he would continue to receive this benefit. I say that because I understand that Mr M has continued to receive PIP. I consider if Pepper Money had carried out a more thorough check into the DLA/PIP it would have been reasonable for it to include the income it did in its affordability assessment.

I do not consider it was reasonable to take into account the child benefit. We know that Mr M had two dependent children at the time of the application. We do not know their ages. But the term of the loan was 24 years. It follows that Mr M would not have continued to receive child benefit over the full term of the loan. Therefore, it was not reasonable to include the child benefit income.

If Pepper Money had considered Mr M's income fairly and reasonably, I consider it could have used a figure of £2,828.22 for Mr M's net monthly income.

Pepper Money recorded total expenditure as £959.49 a month. It said that compared against

Office for National Statistics (ONS) data that showed typical expenditure was £732.476 a month. I don't consider that Pepper Money has calculated expenditure fairly. It has used all of the amounts declared by Mr M – even when the equivalent ONS amount was higher. Pepper Money has not provided any reasons why it was fair or reasonable to use the lower figures in those circumstances.

I do not see how it was reasonable to accept that Mr M would on average have zero expenditure on “furnishings, household equipment and maintenance”. The declared amount for utilities was also lower than the ONS figures. If we use the ONS figures where they are higher than what Mr M declared, the total expenditure is £998.74. I consider that would have been a fair and reasonable basis for Pepper Money to assess Mr M's expenditure.

After the second charge loan was taken Mr M would be left with unsecured debt repayments of £391.76, in addition to a mortgage payment of £650 and the payment to Pepper Money of £356.17. So the total including day-today expenditure of £998.74 was £2,396.67. Mr M would be left with a disposable income of £458.55 before stress testing.

Stress test

Pepper Money was required to carry out a stress test against both Mr M's first charge mortgage and its own second charge loan. It used a stress test of 2% on the current fixed rate of both the first charge mortgage and proposed second charge loan. After doing so it said that the payments on the first charge mortgage would increase by £143.85 and on the second charge mortgage by £51.77. Using Pepper Money's figures, that reduced Mr M's disposable income to £364.89. Using my figures, that reduced the disposable income to £262.93.

Pepper Money did not use the 3% stress test recommended by the FPC at the time in question. I agree that MCOB allows lenders to decide what interest rates will likely be in the future for the purpose of carrying out a stress test. But Pepper Money did not have a free hand to set whatever rate it wanted. MCOB said a lender setting its stress test must have regard to:

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

And must be able to justify the basis it uses by reference to (a) and (b).

Pepper Money considers that it had due regard to market expectations when deciding its stress test interest rate. I accept that the information it has taken into account might well show what market expectations were regarding interest rates. But the information it has given us lacks detail. It does not set out when the forecasts were made and they do not all appear to cover the full period.

For example, the Treasury forecasts appear to run only until 2020. That is only a year after the loan was taken out and would not be an appropriate basis on which to decide a stress test figure covering five years.

It is not clear what swap rates were used for the forecast. And while both they and the gilt rates cover the period to 2025 it is not clear when the figures were obtained or that they reflect the figures available to Pepper Money at the time this loan was taken out – bearing in mind the loan was taken out in 2019 and the requirement was only to consider the impact of interest rate increases over the following five years.

Pepper Money was also required to pay due regard to the FPC's recommendation.

The FPC set its stress test of 3% in its meeting of 21 June 2017. Its record of that meeting set out why it considered that 3% was an appropriate figure – it also explained why lenders should apply the stress test to the reversionary rather than the rate at origination, but I will

deal with that later. The FPC's final meeting before the mortgage was granted was in October 2019. It said the recommendation it made in June 2017 still applied.

The 2017 recommendation said that "highly-indebted households were more vulnerable in the event of unexpected falls in their incomes or increases in their mortgage repayments. In an economic downturn, there was a greater risk that such borrowers might need to cut spending sharply, making recessions deeper. This also increased the risk of losses to lenders, not just on mortgages, but on other lending, too" It set out in detail why a stress test of 3% on the reversionary rate, along with other measures, was appropriate to protect against those risks.

Pepper Money took into account the figure that the FPC recommended. It said that "To simply apply a blanket 3% stress rate would have the effect of disregarding the market expectations...In 2019, our basis for determining an appropriate stress test considers several factors, including market expectations, the FPC recommendation."

While I accept that Pepper Money took into account the FPC's recommendation to use a rate of 3% to some extent, it has not shown that it took account of the reasons why the FPC made its recommendation or explained why using a different interest rate for the stress test would overcome the risks the FPC had set out.

Based on the evidence Pepper Money has given us I don't consider that it has shown that it paid due regard to the FPC's recommendation. Its consideration was limited to merely looking at the rate the FPC recommended and comparing it to what it considered to be market expectation of changes to interest rates. I don't consider it has shown that it properly and fully considered all of the factors relevant to show that it had paid due regard to both market expectations and the FPC recommendation.

Pepper Money's position is that it could not be expected to predict that economic conditions would change. But that was one of the reasons given by the FPC for setting the stress test at 3% alongside other measures. The fact that Pepper Money did not consider the potential for unexpected economic downturns supports my finding that it did not pay due regard to the FPC recommendation.

Pepper Money has referred to statements made by the FCA this year around stress testing. But that was not relevant in 2019. The FPC guidance at that time was clear that lenders should use the reversionary rate rather than the originating rate to apply a stress test.

I'd note that MCOB says "that a mortgage lender should not link its determination to market expectations without considering the likely effect of rate changes in accordance with the market expectations on the specific regulated mortgage contract in question." While Mr M might have had a fixed rate at the time in question, it does not necessarily follow that he would take one in the future on his first charge mortgage. And it is not clear whether Pepper Money offers new fixed interest rate products or if it did at the time the stress test was carried out. We don't have the first charge mortgage offer. But the Pepper Money offer does not give Mr M any contractual right to a new interest rate product when the initial fixed rate ends.

I don't consider it was reasonable for Pepper Money to assume that Mr M would automatically switch to a fixed rate on both his first and second charge mortgage. There were a number of reasons why Mr M might not be able to do so. Pepper Money's reasons for using the originating rather than reversionary rate are based on assumptions rather than any independent data – and again it has not shown that it paid due regard to the FPC's recommendations in regard to why using the reversionary rate was appropriate.

Overall, I do not consider that Pepper Money has provided evidence to support that it carried out a suitably detailed analysis why a 2% stress test on the originating rate was appropriate. It has not shown that it paid due regard to market expectations and in particular the FPC recommendations.

In October 2019, the reversionary rate on Mr M's mortgage was 4.19% on a balance of £145,183 with a term of 22 years. Applying an interest rate stress test of 7.19% would increase Mr M's mortgage payment by over £390 a month. The reversionary rate on the second charge mortgage was 11.353% on a balance of £35,147 over a term of 24 years. Applying an interest rate stress test of 14.353% would increase the payment on the second charge mortgage by over £75 a month.

If I deduct the above stress tested figures of £465 from the disposable income of £458.55 that leaves a deficit. It follows that if Pepper Money had acted fairly and reasonably in the way it assessed Mr M's application it would have declined the application. It could not reasonably have concluded that the loan was affordable.

Other points

There is no evidence that Pepper Money knew or ought to have known that Mr M was gambling compulsively.

Mr M said he experienced difficulty in dealing with Pepper Money following a change in his circumstances that meant he could no longer work. He said that he was led to believe it would accept a reduced amount in settlement of the loan only to eventually tell him it would only accept the full balance. He said he complained and Pepper Money gave him £150 compensation.

Mr M said that it was unfair that Pepper Money would not offer him a new fixed rate unless he received advice from a broker – and that it took it too long to pass on reductions to the Bank of England base rate. Mr M said he also complained about that to Pepper Money.

The investigator asked for evidence of the complaints from Mr M and his representative but we did not receive that information.

The difficulty I have is that Mr M appointed a representative to bring a complaint for him. The complaint made to Pepper Money was solely that it did not carry out proper checks before lending to Mr M. That is the same complaint that was referred to us in January 2025.

As far as I can see, the issues about the reduced settlement, the fixed rate and the reductions in interest rate were only brought to our attention in March 2025. Neither Mr M nor his representative have given us the evidence we need to progress those complaints. We do not have any information from Pepper Money about those complaints – and we have not investigated these issues at all. I don't know if Mr M actually wants to pursue these other points. But I am not going to consider them as part of this complaint.

Putting things right

I don't think it's fair and reasonable that Pepper Money charged fees for setting up a loan it should never have agreed to. However, it appears the advice fee of £995 was paid to the broker rather than Pepper Money. Mr M would need to complain to the broker about that fee.

For the same reasons I don't consider it was fair for Pepper Money to charge Mr M any interest. However, I don't think it needs to refund any of the capital payments Mr M made. There was some benefit to Mr M as the proceeds of the loan were used to repay existing unsecured debt.

I can see that Mr M struggled soon after taking the loan and I note what he has told us about his vulnerable circumstances. But the reason he struggled was not just because of the Pepper Money loan. After that loan he'd also taken other debt including another secured loan. It is not clear that this loan was the sole or main cause of the problems Mr M experienced. And even if he did not have this loan he would still have encountered some difficulties in managing his existing debt in view of the change in his circumstances. He will also benefit from my award of refunded interest, because had he not taken these loans the debts he consolidated would have remained interest bearing unless he came to an arrangement with his creditors or entered an insolvency procedure. So I am not proposing to make any award for in respect of any distress and inconvenience suffered by Mr M.

Mr M accepted my provisional findings. Pepper Money did not. It responded to make a number of points, including:

- It did know the ages of Mr M's children – one was 13 years old and the other was 17. Its policy was to include child benefit where children were aged 14 or under as it was likely that such income would continue for a meaningful period. That was in line with expectations under MCOB 11.6 to consider affordability for five years and take reasonable steps to consider the entire term. It only took into account the child benefit for the younger child and the expenditure for both children. At the end of the five year period it was reasonable to assume the elder child would no longer be financially dependent on Mr M.
- The income from child benefit could be included in Mr M's income – so the correct figure for income was £2,911.92.
- It was incorrect to say that it had used all of Mr M's declared expenditure rather than the higher of the declared and ONS figures. Incorrect figures were originally submitted to us.
- Pepper Money did have regard to the FPC recommendation. It justified a 2% stress test by reference to both market expectations and the FPC recommendation as required under MCOB 11.6.18R – and that was demonstrated in the 2019 mortgage stress test paper provided. If the FCA had intended that a figure below 3% would be presumed to be irresponsible then that should have been made clear in the regulatory requirements at the time – the reason it wasn't was because the FCA's intention was not for the FPC recommendation to be treated as a minimum and we should not apply that approach retrospectively.
- In any case, once child benefit is correctly accounted for Mr M would have passed stress testing at 3% - so the 2% figure did not affect the lending decision in this case.
- It was incorrect to say that there was a requirement or regulatory expectation that it should use the first charge lender's reversionary rate when stress testing and the FCA has made that clear. It did use the reversionary rate for the second charge loan.

- Once adjusted for the treatment of Mr M's child benefit his monthly disposable income rises to £515, which is sufficient to cover an interest rate stress test of 3% on both loans.
- Mr M's financial difficulties are as a result of his subsequent borrowing rather than its lending decision.
- If Mr M did not take the second charge loan he would have had to continue to pay the unsecured loans on a higher interest rate, which would have made his financial difficulties worse, particularly in view of later interest rate rises. Or he could have sought help with his debts. But that would have adversely affected his credit file.
- Mr M achieved his objectives by taking the loan. It reduced his outgoings by £255.97 a month. He repaid it in full with no detrimental impact on his credit file.
- Under Consumer Duty it is obliged to support customers to achieve their financial objectives, including a wish to consolidate debt and reduce outgoings. It looks to balance a prudent approach to credit risk and affordability against the risk of foreseeable harm if customers who are able to afford their products are unnecessarily turned away.

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.

Child benefit

MCOB 11.6.14R says:

If a firm is, or should reasonably be aware from information obtained during the application process, that there will, or are likely to, be future changes to the income and expenditure of the customer during the term of the regulated mortgage contract or home purchase plan, the firm must take them into account when assessing whether the customer will be able to pay the sums due for the purposes of MCOB 11.6.2 R.

The term of the mortgage was 24 years. Pepper Money should reasonably have been aware that Mr M would not continue to receive child benefit during the term of the regulated mortgage contract. Therefore, I do not consider it was reasonable for it to take that income into account.

Pepper Money has explained that it only used the child benefit received for Mr M's younger child who was 13 years old at the time of lending. It said it was reasonable to assume that income would continue for at least five years.

I do not consider that it has fairly or reasonably taken into account the foreseeable changes to Mr M's income. He only qualified for child benefit until his child was 16 years old – that was under three years after the loan was taken out. Once the child was 16 Mr M would only qualify for child benefit if they stayed in approved education or training. Pepper Money could not have known that at the time in question.

In any event, I don't consider it was reasonable to take child benefit into account at all. I say that as Mr M would not receive it over the full term of the loan. So the child benefit amount of £89.70 month should not have been included as part of the income.

Pepper Money said that we'd previously endorsed its approach. But we assess each case

on its individual facts, and in the circumstances of this case I'm not persuaded it was reasonable to include child benefit for the reasons I've explained.

Expenditure

Pepper Money told us that it actually used a figure of £985.21 for Mr M's expenditure. It said that where the ONS figure was higher than what Mr M had declared it used the higher figure – apart from spending on utilities, which was within 15% of the ONS amount. And the difference was £13.53, which was covered by the disposable income.

I don't consider that approach is necessarily unreasonable – there might be valid reasons why a specific borrower has lower than average spending in a particular category of spending. I might usually expect that to be challenged and for a lender to look for an explanation that supports the difference is realistic and sustainable. I can't see that Pepper Money has put forward that it received such an explanation from Mr M.

Reversionary rate

Pepper Money said that the FCA considered whether stress tests should be applied to the originating or reversionary rate in its policy statements PS12/16 and PS15/9. PS 15/9 on implementation of the Mortgage Credit Directive and the new regime for second charge mortgages said, as relevant:

We accept that the outstanding balance can be used to assess the impact of an interest rate rise, in conjunction with the monthly payment. The outstanding balance is available on a credit reference, and the lender will already need to know the monthly payment as it is an item of committed expenditure in the affordability assessment. Therefore, as outlined in Chapter 3, we have amended the rules (MCOB 11.6.18AR(2)) to remove the need to obtain the interest rate. This will simplify matters for firms.

A lender must consider market expectations and any prevailing Financial Policy Committee recommendation on appropriate interest rate stress tests, as per MCOB 11.6.18R, to determine any margin it applies in the affordability test for both the second charge and higher priority mortgages.

We do not propose to amend the rules to require firms to stress test against the reversion rate. We accept that second charge lenders will not have full details of higher priority mortgages, or the assumptions used by those lenders to assess the impact of interest rate increases, and that requiring second charge lenders to obtain such details is likely to prove unworkable. So while this interest rate stress test is not a perfect test of future affordability, we believe it represents a proportionate and practical approach.

That was a statement of the FCA's intentions in 2015. While it said at that time it didn't include in the rules a requirement for firms to stress test on the reversionary rate, it did say that under MCOB 11.6.18 AR (2) .Under MCOB 11.6.18AR(2) in coming to a view as to likely future interest rates, Pepper Money was required to pay regard to market expectations and any prevailing FPC recommendation on appropriate interest rate stress tests. At the time lending in October 2019, the FPC's recommendation on appropriate interest rate stress tests said that they should be based on lender's reversion rate – not the originating rate.

In my view, the fact that the FPC's recommendation had changed since the FCA's 2015 statement was a relevant factor that Pepper Money ought to have taken into account. I don't think that the FCA's 2015 statement that it hadn't included this requirement expressly in the rules means that any later FPC recommendation to test on the reversion rate should not be followed. Applying MCOB 11.6.18 AR (2), the changed FPC recommendation is something

firms should have regard to notwithstanding that this wasn't its recommendation when the rule was introduced. I think the FCA's policy statement is designed to allow the operation of the stress test to change over time, having regard to changed recommendations, rather than to fix for all time that stress tests should or should not be based on the reversion rate.

The evidence Pepper Money has given us does not support that it paid regard to the FPC recommendation when deciding to stress test the interest rate against the originating rate. Its paper dated September 2019 quotes part of the FPC recommendation, including that the stress test should be on the reversion rate. But the paper does not include any rationale to support why it was appropriate to continue to use the originating rate for the stress test.

Having regard to" does not necessarily mean "following". But if Pepper Money did decide to depart from the FPC recommendation, I would expect to see a rationale for doing so taking the reasons for the recommendation into account. I do not consider Pepper Money has shown that it had regard to the FPC's recommendation. I consider the recommendation is persuasive and in the absence of reasons for not following it, I don't consider it was fair and reasonable to stress test on the reversionary rate. I've therefore gone on to consider what the outcome would have been if it had been stress tested on the reversionary rate.

I do not agree it is impractical or unworkable for a second charge to obtain details of what the reversion rate would have been. That would simply involve asking the customer for a copy of their first charge mortgage offer.

Stress test

I thank Pepper Money for highlighting the September 2019 paper that set out its reasons for setting the stress test at 2%. That paper provides more detail about the information it used in respect of market expectations. For example, it sets out the type of gilt yields and swap rates it used and the dates and sources of that information. But I do not think that changes my overall conclusions. I will explain why.

I accept that MCOB did not set out that any stress test below 3% was irresponsible or that 3% was the minimum that could be used. I agree it is possible under MCOB for a lender to use a different stress test percentage, providing it has paid regard to market expectation and the FPC's recommendation. I am not applying that retrospectively – that is what MCOB said when the lending decision was made in October 2019.

In its response to my provisional decision Pepper Money said its rationale for selecting a 2% stress test included:

- Recognition that the FPC's 3% recommendation was conservative and aimed at systemic risk mitigation across a broad range of lender types, without regard to the specifics of individual lender or customer decision-making,
- The fact that multiple market data sources indicated a low probability of significant interest rate rises at the relevant time
- Evaluation of whether the recommendation was proportionate for second charge lending, where loans are typically used for debt consolidation rather than new borrowing.

I accept that the FPC's responsibilities included taking action to reduce systemic risks and that the stress test recommendation was part of that. But it was a requirement of MCOB for lenders to pay regard to the FPC recommendation when deciding what stress test to use and recommendations aimed at addressing systemic risks are only effective if lenders follow them. Therefore, the intention was for lenders to weigh up both what the FPC had said along

with market expectations in deciding what an appropriate stress test to use was.

The FCA must have known the parameters under which the FPC set its stress test when it included that requirement in MCOB. Therefore, I do not consider that a lender could reasonably put aside the FPC's recommendation merely because of what the FPC's aims were. If that were a valid reason then there would not have been any point in including a requirement for lenders to pay regard to the FPC recommendation in the first place.

At the time MCOB applied to second charge lenders. Pepper Money said that it had evaluated whether the FPC recommendation was proportionate for second charge lending where loans are typically used for debt consolidation – as in this case.

Pepper Money's September 2019 paper said:

“The FPC’s primary purpose in setting a stress test is to guard against economic instability caused by household indebtedness, and this objective appears to have led it to take a cautious approach.... As Optimum’s loans are typically used for debt consolidation rather than to extend indebtedness, it is questionable whether the FPC’s recommendation is the most appropriate stress to apply.... It is clear that the FPC’s position is rather conservative when compared with market expectations of interest rate movements. Simply applying the FPC’s recommendation could lead to some applicants being inappropriately denied access to credit and it is therefore recommended that, for the purposes of affordability stress testing, an interest rate increase of 2% should be applied.”

I am not sure it is accurate to say that Pepper Money's loans do not increase indebtedness. In many cases, fees are added to the loan. In this case, Mr M had around £30,000 of unsecured debt that he consolidated, plus fees and almost £3,000 in cash – making his total borrowing £35,147. So he actually increased his overall indebtedness because of this mortgage. And the loan-to-value including his first charge mortgage increased from 74% to 92% - because by virtue of this lending, his existing indebtedness moved from being unsecured to being secured.

Even if Pepper Money's lending does not increase indebtedness as it is usually for debt consolidation, it does not necessarily follow that a borrower taking that step would not remain highly indebted or susceptible to the risks set out by the FPC. The level of debt remains the same - but secured rather than unsecured. It may in some cases reduce more slowly over a longer term than it would have had it remained unsecured. In many cases it might also remove some flexibility, for example borrowers are expected to prioritise secured debt and are unable to vary the payments to a secured debt as they could to, for example, a credit card debt. There is also less flexibility in coming to arrangements or entering insolvency where the debt is secured. It also increases the risk for the borrower as the debt is secured against their home.

Looking at what Pepper Money has told us I do not consider it has really shown that it paid regard to the FPC recommendation. Rather it has come up with reasons why it should disregard what FPC said because of its aims in setting the stress test and because it was not proportionate for second charge lending that is typically for debt consolidation. I've explained why I do not consider that was reasonable.

So that leaves Pepper Money's reliance on the market data. But I've already explained that it was required to pay regard to both market expectations and the FPC recommendation in setting its stress test. I do not see how I could find it had acted fairly or reasonably by putting as much weight as it has on market expectations over the FPC recommendation. In considering whether Pepper Money lent responsibly, therefore, I'll take into account what the affordability assessment would have been had it stress tested at 3% on reversion rate.

Income and expenditure

I've found if Pepper Money had acted reasonably it would have used an income figure of £2,828.22 (£2,917.92 - £89.70 in child benefit). If I give Pepper Money the benefit of the doubt and accept the day-to-day expenditure figure of £985.21, Mr M would be left with unsecured debt repayments of £391.76, in addition to a mortgage payment of £650 and the payment to Pepper Money of £356.17. So the total expenditure would be £2,383.14 – leaving Mr M with £445.08.

In October 2019, the reversionary rate on Mr M's mortgage was 4.19% on a balance of £145,183 with a term of 22 years. Applying an interest rate stress test of 7.19% would increase Mr M's mortgage payment by over £390 a month. The reversionary rate on the second charge mortgage was 11.353% on a balance of £35,147 over a term of 24 years. Applying an interest rate stress test of 14.353% would increase the payment on the second charge mortgage by over £75 a month.

If I deduct the above stress tested figures of £465 from the disposable income of £445.08 that leaves a deficit of £19.92. It follows that if Pepper Money had acted fairly and reasonably in the way it assessed Mr M's application it would have declined the application. It could not reasonably have concluded that the loan was affordable.

Even if I applied a 2% stress test on the reversion rates (and I am not persuaded that was fair or reasonable in the circumstances) – so 6.19% and a payment of £1,008.08 a month on first charge and 13.353% and a payment of £407.87 a month on second charge – that is a difference of £409.78 a month. That would leave Mr M with £35 a month. That is a very low amount and does not allow for contingencies. I do not consider it would have been reasonable for a responsible lender to lend in those circumstances – particularly where it had accepted a lower figure for utility bills. I say that as Pepper Money had a duty to pay regard to Mr M's interests and to treat him fairly. There was a significant risk of harm to him if the mortgage turned out to be unaffordable – it was secured against his home unlike the debt he was consolidating.

Customer outcomes

Pepper Money has referred to the Consumer Duty. But that only came into force on 31 July 2023, so is not relevant to my decision in this case. I agree that sometimes by giving secured loans for debt consolidation it can enable consumers to meet their financial objectives. And there may be harm if they can't do that when the loan was affordable. But there is also a risk of harm if a consumer is given a secured loan that they can't afford.

It is not clear what Mr M's financial position would have been if he'd not taken this loan. I accept that his unsecured debts would have remained in place. They might have had higher interest rates, but they were not secured against Mr M's home and if Mr M fell into financial difficulties there are likely to be other types of forbearance that unsecured lenders could offer.

I accept Mr M had the benefit of the proceeds of the loan in repaying existing debt. But I do not consider Pepper Money treated Mr M fairly when it gave him the loan. Therefore, I do not consider it would be fair for Pepper Money to benefit from the interest on the mortgage.

My final decision

My final decision is that UK Mortgage Lending Ltd trading as Pepper Money should:

- Recalculate the settlement balance of the first loan to remove all fees and all interest charged – apart from the advice fee of £995.
- If Mr M paid more than the recalculated settlement figure to repay the loan, pay Mr M the difference between the revised settlement figure and the amount Mr M paid.
- Pay interest at 8% simple per year from the date the loan was repaid until the date this complaint is settled. Pepper Money may deduct income tax from the 8% interest element of my award, as required by HMRC. But it should tell Mr M what it has deducted so he can reclaim the tax if he's entitled to do so.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr M to accept or reject my decision before 5 January 2026.

Ken Rose
Ombudsman