

The complaint

Mr G is unhappy with the way in which Pepper (UK) Limited trading as Engage Credit (Pepper) has applied interest to his tracker mortgage, following changes to the Bank of England base rate (BoEBR).

What happened

Mr G holds an interest only mortgage for which Pepper acts as the mortgage administrator. The mortgage was originally taken out in 2004, for a term of twenty years and on an initial two year tracker rate deal. At the end of that deal (in 2006), Mr G took out another tracker rate deal, this time covering the lifetime of the mortgage – over an eighteen year term. It looks like Pepper began administering the mortgage in May 2020 and Pepper is responsible for dealing with the complaint raised.

Since the mortgage has been with Pepper, the BoEBR has changed (increased) on a number of occasions. In October 2022, Mr G complained to Pepper that it had increased the interest rate on his mortgage prematurely, following increases to the BoEBR and this had resulted in him paying more interest than he should. He said that when the BoEBR had previously fallen, his then lender had confirmed that changes to the interest rate happen a month later than what Pepper had been doing. He asked Pepper to give him the excess interest back and to pay some compensation for the inconvenience caused to him.

Pepper didn't uphold the complaint. It said that interest had been charged and the monthly payment amount changed in accordance with the terms of the mortgage offer from 2006. It said this was consistent with what the original lender had done.

Mr G remained dissatisfied. He emphasised that he wasn't unhappy with the timing of the change to his payment amount – only the timing of the change to the interest. When he couldn't get anywhere further trying to resolve things directly with Pepper, he referred his concerns to the Financial Ombudsman Service. An investigator here initially rejected the complaint, saying they thought interest had been applied correctly.

However, after Mr G made further representations, the investigator thought the complaint should be upheld. They said they thought Mr G was correct in saying that the changes to the interest charged should have happened a month later than they did. The investigator recommended that Pepper refund the difference in interest plus 8% and that it should pay Mr G £250 in compensation for the distress and inconvenience caused to him.

Pepper disagreed and so the case was passed to me to decide. I issued a Provisional Decision (PD) in September 2023. In it, I said:

“The relevant part of the mortgage offer (Section 4) states the following:

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

- a variable rate which is 0.49% above the Bank of England, currently 4.50%, for the entire life of the mortgage, giving a current rate payable of 4.99%.

If the Bank of England Base Rate changes, we will review the interest rate applicable to your mortgage on the first working day of the following month. We will then notify you in writing of your new interest rate and payment, which will take effect from the first day of the month following the review. We will follow this procedure whether the Bank of England Base Rate rises or falls.

Pepper says that this term allows it to change the rate of interest on Mr G's mortgage on the first day of the month following a change in the BoEBR. So if, for example, the BoEBR changes in January, it says the term allows it to change the interest rate on the first day in February.

Pepper's position seems to centre around the part of the term that says "....your new interest rate and payment, which will take effect from the first day of the month following the review." It seems to be saying that "the review" means the change to the BoEBR.

However, the word "review" is mentioned earlier on in the term "....we will review the interest rate applicable to your mortgage on the first working day of the following month....". With "the following month" meaning the month after the change in the BoEBR. In the absence of any alternative definition of what is meant by "review" the only reasonable interpretation of what is meant by "review" the second time it is mentioned within the term, is how it is defined earlier in the term i.e. the review by the lender on the first working day of the month following the change to the BoEBR.

As such, where the term says that the change in interest will take effect from the first day of the month following the "review", this must logically mean that the interest rate change doesn't take place the month following the BoEBR change, but the month after that. It's possible this isn't what the drafter of the term intended. However, I consider the only reasonable interpretation of the term as written is as I have said.

This means that where a change to the BoEBR takes place in a given month (e.g. January), the interest rate changes the month after the month after that (e.g. March).

I have not seen any alternative definition of what is meant by "the review" within the mortgage offer. I've not been provided with a copy of the general mortgage terms and conditions, but I have seen a copy of the original lender's "Mortgage Offer General Conditions" 2005, which are likely to have applied to Mr G's mortgage. This doesn't contain an alternative definition for "the review" nor anything else that would change the meaning of the relevant term within the mortgage offer.

Mr G has made the point that this is how his contract operated when the BoEBR has fallen in the past and he has understandably raised a concern about how Pepper's approach is inconsistent with what the previous lender did at that time and that this inconsistency very much works against him. Pepper seems to be saying that its approach is consistent, but it is not.

Regardless, I find the term is clear in saying that the change in the interest rate takes place the month after the month after a change in the BoEBR. So this is what Pepper should have done and the basis for what it needs to do to put things right.

Putting things right

My understanding is that the mortgage is still running (it not being due to expire until 2024).

That being the case, I am currently minded to say that Pepper needs to restructure Mr G's account as though each of the interest rate increases happened one month later than they did. Pepper will need to then calculate a new contractual monthly payment (CMP) and inform Mr G what this is.

In addition, Pepper's actions have caused Mr G unnecessary distress and inconvenience. Bearing in mind the upset this situation has caused and the time and effort Mr G has spent trying to get things sorted, I currently think that an award of £300 is appropriate and in line with our general approach to compensation awards...."

I asked both parties to provide any further evidence and/or arguments by 23 October 2023. Mr G responded to say that he agreed with the decision I'd reached. He said though that he was likely to repay the mortgage in the near future and that if the account restructure isn't completed before the mortgage is redeemed, he should receive a refund of the overpayments plus 8% simple interest (which was what the investigator had originally suggested). He also said that he wished to see statements showing the daily balances from 01 January 2022.

Pepper responded to say that it still thought it had administered the account correctly and that the CMI it had charged was correct. It said that as the CMI is calculated in arrears, it does not make sense for the interest rate and payment amount to change on the same date, as this would result in the borrower being asked to overpay for the prior month.

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.

Having done so, I see no reason to depart from my provisional findings on the substantive issue of the application of section 4 of the 2006 Mortgage Offer.

I still find that the natural meaning of the term (which is contained above within my PD, which forms part of this final decision) is that the change in the interest rate takes place the month after the month after a change in the BoEBR. So it remains my view that this is what Pepper should have done and is still the basis for what it needs to do to put things right.

Nothing Pepper said in response to my PD engages with the detail of my analysis of what the term actually says and what that means.

In terms of what it has said about the interest being calculated in arrears, I think I understand the point it is making. But it is irrelevant in the sense that it doesn't change what the term says about the timing of changes to the interest rate. Pepper must follow what the contract says and it cannot charge more than the contract permits for its own administrative convenience.

Putting things right

Mr G has said that he may be redeeming the mortgage very soon. As such, Pepper must do one of two things, dependent on the timing of any redemption.

If the calculation and restructure of the account can take place before the mortgage is redeemed

Pepper must restructure Mr G's account as though each of the interest rate increases

happened one month later than they did. Pepper will need to then calculate a new contractual monthly payment (CMP) and inform Mr G what this is. Pepper must provide its calculations to Mr G, so that he is able to understand how the later application of the interest rate increases impacts the outstanding balance over time.

If the calculation and restructure of the account cannot take place before the mortgage is redeemed

Pepper must refund Mr G the additional interest he has paid, plus 8% simple interest, from the date the additional interest was charged through to the date of payment.

Regardless of which scenario applies, Pepper must also pay Mr G £300 in compensation for the unnecessary distress and inconvenience caused to him – reflecting the time and effort he has spent trying to get things sorted. I still consider this is a fair amount of compensation and in line with our general approach to compensation awards.

My final decision

My final decision is that I uphold Mr G's complaint about Pepper (UK) Limited trading as Engage Credit and I direct it to do what I've set out above under 'Putting things right'.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr G to accept or reject my decision before 10 November 2023.

Ben Brewer
Ombudsman