

The complaint

Mr E complains that Pepper (UK) Limited trading as Pepper Money told him his mortgage had been permanently converted to interest only terms, but then went back on that.

What happened

Mr E has a mortgage with Pepper Money. In 2018 he borrowed around £274,000 on repayment terms over a term of 22 years. The mortgage was on a fixed rate for the first 30 months, followed by a variable rate set at 4.15% above LIBOR.

Unfortunately, Mr E lost his job and experienced some financial difficulty. So he contacted Pepper Money and asked for help.

Pepper Money agreed to an interest only payment arrangement in September 2022. It says the agreement was that it would collect only the interest for five months, but the mortgage would stay on repayment terms and from February 2023 Mr E would be expected to resume paying the capital as well as interest. At the end of that period, Pepper Money wrote to Mr E setting out his new monthly payment on repayment terms.

Mr E complained to Pepper Money. He said that the new monthly payment wasn't affordable for him. He said that while he had agreed to a five month payment arrangement in September 2022, since then Pepper Money had agreed to switch the mortgage over to interest only permanently, and it should honour that.

Pepper Money said that there had been a call on 8 December 2022. Mr E rang up to find out what his monthly payment will be after the end of the payment arrangement. The agent he spoke to told him that his mortgage was on interest only for the rest of the term. He could voluntarily make overpayments, but it couldn't be switched to repayment – to do that Mr E would need to move to another lender.

Pepper Money accepted that it had given Mr E wrong information on that call. It said the agent had made a mistake and misunderstood what was happening with Mr E's account. But the mortgage had in fact not been permanently switched to interest only – and Mr E had understood that was the agreement in September. So he should have realised this was a mistake. It offered £100 compensation for the upset the mistake had caused Mr E, but said that his mortgage would remain on repayment terms and Mr E would need to make the full payment.

Mr E wasn't happy with that. He said he'd been led to believe that his mortgage would now remain on interest only for the rest of the term. He'd checked this several times. He'd made other arrangements in reliance on that – thinking his outgoings would be less, he'd committed to a credit agreement to fund home improvements. As a result, the higher mortgage payment on repayment terms wouldn't be affordable for him. He said that he wanted Pepper Money to honour the switch to interest only, or to reduce his payment in some other way such as extending the term or reducing the interest rate, to make it affordable.

Our investigator thought that Pepper Money had made a mistake on the call in December 2022. But she didn't think it would be fair to require it to honour the mistake and convert the mortgage to interest only permanently. She said that Pepper Money should increase its offer of compensation to £300 to reflect the upset caused to Mr E.

Pepper Money agreed with that, but Mr E didn't. So the complaint comes to me for a decision to be made.

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.

Looking at the history of the mortgage and Mr E's contact with Pepper Money, I can see that he lost his job and took a coronavirus payment deferral in 2020. He managed to secure another job, but lost that in late 2021. He missed the November 2021 mortgage payment.

From December 2021, Pepper Money agreed a reduced payment arrangement of £500 per month. Over this period, Mr E said that he was now starting a self-employed business, but later found a new job. He asked Pepper Money to agree to an interest only payment arrangement several times, but Pepper Money didn't agree. It set payment arrangements at levels it thought were affordable for Mr E having reviewed his income and expenditure. Because of the missed payment in November, and the reduced payments thereafter, the mortgage went into arrears. By mid February 2022 the mortgage was almost £3,500 in arrears.

In February 2022, Pepper Money did agree to an interest only payment arrangement, for a three month period, to start from March. Pepper Money refused a further extension – Mr E had wanted a further six months on interest only terms. On review, Pepper Money agreed a one month extension for June, and then a further three months from July. Mr E actually paid more than the interest only amount each month. Because Pepper Money reduced the monthly payment due during this period, that meant Mr E began to reduce the arrears.

By the start of September, the mortgage was in arrears of around £1,500. Mr E cleared the arrears on 1 September 2022, alongside making that month's payment.

Meanwhile, in August, Mr E asked for a further three month extension to take him to the end of January 2023. He said he was due to receive a promotion with a significant salary increase and was awaiting confirmation of a start date. Mr E was unable to provide evidence of the salary increase.

Pepper Money initially declined his request on the basis that he had had a significant period on interest only already, which would increase the monthly payments when it came to an end. It was concerned that the mortgage would not be sustainable for Mr E over the longer term. However, on review, Pepper Money agreed to a further interest only extension to 1 February 2023.

Pepper Money discussed this further extension with Mr E in a call on 1 September:

Pepper Money (PM)	We've approved for you to have another five months on interest only and that ends in February 2023
Mr E	So the last payment would be 1 February

PM	Yes, last payment on interest only would be February, yes
Mr E	Right, OK, perfect
<i>Discussion about paying off the arrears – Mr E will do today or tomorrow</i>	
PM	Just to make you aware, at the end of the five months, so from the beginning of March next year, your contractual monthly instalment will increase. So hopefully by then you will have got everything in place, because you're still waiting on your promotion aren't you
Mr E	Yes, and if not I'm going to change my mortgage by then, I got declined because of the arrears but in three months' time they said to try again and it should be OK. What are my monthly payments going to be?
PM	Your instalment is ... [checks] ... £1,069.01 ...
Mr E	So if I pay about £1,100 a month for the next five months that will about cover it
PM	Yes it will do

Pepper Money sent Mr E a letter on 2 September 2022 confirming this arrangement. The letter says

We have agreed to temporarily switch your mortgage to interest only for 5 months. This means you only need to make interest payments on your mortgage until 1 February 2023.

During your interest only period

During this switch to interest only, your payments will be £965.98. Your mortgage balance will not reduce and interest will be charged on it, so you will pay more interest over the remaining term.

As we have agreed to this temporary switch to interest only, it will show that you are under an arrangement on your credit file and you will not have to pay any other fees or charges ... While you maintain the agreed payment, no arrears will accrue on your account under this arrangement...

At the end of the temporary switch to interest only, we will recalculate your monthly payment based upon your outstanding capital balance and your payment is likely to increase. We will contact you at the end of your temporary switch to interest only to confirm your new payment amount.

There were more calls with Pepper Money over this period. In October, Mr E wanted to clarify how his mortgage was being reported to his credit file now he had cleared the arrears. He complained that an arrangement was still being reported.

The crucial calls were on 8 December 2022. There were two calls on that date. Pepper Money has given us a transcript of the first call and a recording of the second.

Pepper Money's transcript of the first call says, so far as is relevant:

Mr E	I have been switched over to Engage Credit from Pepper Money so what would happen after with interest only, my agreement runs out in February with interest only does it go back to repayment
Pepper Money (PM)	Not that I can see, let me just have a look, no it will just stay as an interest only mortgage
Mr E	For how long
PM	For the life of the mortgage
Mr E	So I will then need to switch over my mortgage in order to go back to capital
PM	You will need to seek a new lender or broker
Mr E	If I'm with you for life on interest only can I clear my mortgage by making overpayments each month
PM	You can
Mr E	If I'm paying around £1250 each month on interest only and any additional payment will go towards the capital
PM	Yes that's right
Mr E	So I can stay with you for life and pay off my mortgage that way and it will never change I will be paying what the interest is
PM	That is correct.

The relevant section of the second call went like this:

Mr E	I was led to believe that I was going to be on interest only with Pepper until February next year. But I don't really understand what's happened with my account now. So could you just please let me know, I'm on interest only with you for how long?
Pepper Money (PM)	Let me check this. Just to confirm, you were previously on capital repayment, but now you're on interest only?
Mr E	That's correct yes
PM	And you're just wanting to know how long the interest only payments will last for
Mr E	Yes
PM	<p>Bear with me one moment. I'm just going to review the account notes and I'll come back to you in just a moment.</p> <p>Sorry for the hold. I've looked at the account. You have an interest only mortgage which is set to expire June 2040</p>

Mr E	Oh. 2040?
PM	Yes, June 2040. So you've got 211 months remaining.
Mr E	So that's 17 years, just under 18 years I believe
PM	That's correct yes
<i>[discussion about interest rates]</i>	
Mr E	My credit report keeps showing an arrangement. I'm not in an arrangement now am I because I'm paying an interest only mortgage
PM	It shows that you're on an arrangement?
Mr E	Yes, it's marking my credit file on Equifax as an arrangement. But I've got no arrears with you guys at all have I, I am up to date with my file
PM	That's correct, yes
Mr E	Yes. So it shows me as an arrangement, but I'm not making an arrangement. An arrangement to me is if you're in difficulties, you're not paying the amount you're meant to pay and you're paying a lesser arrangement amount, I get that, but I'm paying whatever the interest amount is, I'm paying over that, I'm paying £1,250 a month because I wasn't quite sure how much it was
PM	Yes. From what I can see here, I think there was a temporary interest only conversion we did, the account was only capital repayment, we then offered the temporary interest only conversion from February this year. I think the last one ended in October this year. But it's still showing as interest only on the account. I think where the credit file impact may have arisen from, is because you are on an interest only conversion, that in itself would mark up as an arrangement flag on your credit file
Mr E	Will that continue to happen, because it makes it very difficult for me to get a better rate for my mortgage, for me to re-mortgage
PM	Unfortunately it would continue to happen. I know there's a complaint been logged regarding that, I know that you're saying you weren't made aware that an interest only conversion would impact your credit file
Mr E	No I wasn't
PM	But from my understanding, essentially it's not an arrangement but because it's an amendment to the original terms, it would show on the credit file as an arrangement as such because you're paying less than what was initially agreed. But as I said there's a formal complaint being looked at regarding that
Mr E	But all I wanted, because obviously that arrangement has finished now and that agreement I had originally has run out now, it's finished, so in theory if I took out another contract now with another lender that was interest only I wouldn't be showing as in an arrangement, so... I'm paying what I'm meant to be paying, I'd like it to show as normal payment now because it's making it very difficult for me to get a different mortgage and treating customers fairly,

	it's not really helping me. I can't obtain a mortgage at the right rate I deserve to, because I've got a good credit rating, it's just this
PM	I agree with what you're saying there, but we'd have to wait for the investigation of the complaint to be finished. It is in the hands of the complaints team, they will have to review the situation. I'll apologise if you weren't made aware that an interest only conversion would impact it, and I suspect that you may have acted differently had you been informed of that, but at the moment we're going to have to carry on with the complaints process before you would be given your FOS rights
Mr E	OK, cool. So just so I'm aware, I'm on interest only now, that's not going to change, the only time it will change is if the interest rate goes up or down, and I can change my mortgage at any time with no exit fees
PM	That is correct yes, there will be no exit fee, no early repayment charge. You are on a variable rate at the moment, on interest only, and as I said there is an active complaint being looked into regarding the credit file reporting
Mr E	Would I not get a new contract sent out to me if it's been changed from Pepper to Engage Credit, all we have is stuff from Pepper
PM	Essentially we're the same company, under the umbrella of Pepper, so we service on behalf of Pepper but Pepper are still our parent company. The terms and conditions of the original mortgage remain the same, as would be noted in the welcome letter we sent out, but essentially we're just servicing on behalf of the lender Pepper
Mr E	OK. Just so I can get something else straight, just say if after 211 months and I still owe £249,000 at that point I'd have to sell the house and give you the settlement and keep whatever's mine
PM	Well yes. In those situations there's three options. Either you can pay the balance throughout the remaining term, either you could sell the property at the end, or you could re-mortgage towards the end. They're generally the three options for interest only customers
Mr E	Obviously I'll be too old then, I'll be in my sixties so I won't be able to re-mortgage
PM	Or equity release as well, that's always another option for older customers, I appreciate at that age you may not be considered for another mortgage, so equity release is another option as well
Mr E	Right OK. I'll look into that. So if I can get that complaint, because it's been going on for a while now, obviously I don't want to continue this and lose a mortgage opportunity and then I'm still going to have the same problem a year down the line, because I should be out of an arrangement now, I'm paying interest only and that's...
PM	I get what you're saying there. As I said the complaint has an eight week response time, that coming to an end now, so I suspect you'll get a final response in the coming days

Mr E	Perfect thank you
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On 6 February 2023, Pepper Money sent a further letter. It said

Your period of short-term payment assistance has ended. If you have not contacted us to discuss your current circumstances and we have not agreed to any longer term assistance, your payments will start on 1 March 2023 and your new contractual monthly payment will be £2,091.57.

It was this letter, and the switch back to repayment terms, which led to Mr E's complaint. I understand why Mr E is unhappy about what happened, and feels that Pepper Money misled him.

Having looked at everything that happened, I think Pepper Money was clear with Mr E throughout that he was only being offered the latest in a series of temporary switches to interest only, and that his mortgage was due to switch back in February 2023. That was made clear when the arrangement was agreed in September, and Pepper Money confirmed that in its 2 September letter.

I'm satisfied Mr E understood that at the time, because he confirmed that was his understanding at the start of the first call on 8 December, and said at the start of the second call that he was now confused following the first call – because he thought he had a five month arrangement but had been told on the earlier call that it was a permanent switch. On this second call, Pepper Money again told Mr E that his mortgage had been permanently converted to interest only.

This wasn't correct. Pepper Money hadn't converted his mortgage to interest only permanently. It couldn't do so without a formal application and checking that Mr E had a strategy for repaying the capital at the end of the term. Mr E's mortgage was still a repayment mortgage, and due to switch back to full repayment from February 2023 – as had been agreed in September 2022.

Pepper Money misled Mr E about this in both the calls on 8 December. That shouldn't have happened. But I don't think it would be fair and reasonable to require Pepper Money to convert the mortgage to interest only permanently because of that mistake. The mistake doesn't change the fact that Mr E has a repayment mortgage, and it wouldn't be appropriate to require Pepper Money to make a change to a permanently interest only mortgage, a fundamentally different agreement and where Mr E has no repayment strategy, because of that mistake.

However, the fact is that Pepper Money did make a mistake. It's fair that it compensates Mr E for the consequences of that mistake, including in respect of action he took relying on the mistake.

Mr E says that his mortgage is unaffordable on repayment terms. He says that he entered into other credit arrangements believing that his payments would be less, and his mortgage is unaffordable as a result.

But I'm not persuaded that Pepper Money should convert the mortgage to interest only because of this. Despite the mistake, Pepper Money had made clear several times on other occasions that it was only offering temporary interest only concessions. Unlike in September, there was no confirmation in writing that the mortgage had been permanently converted to interest only. Given his recent financial difficulties, and given his understanding of what had

happened prior to the December calls, I'm not persuaded that – if this was the sole reason he committed to the other credit agreement – it was reasonable to do so relying solely on the December calls.

Following the switch back to repayment terms, Mr E made the full payments required on 1 March and 1 April. In April he requested further assistance, and Pepper Money agreed to reduce the interest rate on the mortgage for six months as a concession – this reduced the monthly payments (on repayment terms) to £1,700 per month from £2,091.57. Mr E made those payments for the next few months – but then his circumstances changed as he lost his job.

By the end of the interest only arrangement, in February 2023, Mr E had been on that arrangement for a year. It's not possible to convert the mortgage to interest only permanently without a formal repayment strategy (not including sale of the property). So the mortgage would have to be converted back to repayment terms at some point – the longer it was on interest only in the meantime, the higher the monthly payments would be on reversion. That's because the amount of capital repayments deferred increases, while the time left on the mortgage term to repay the capital reduces. An interest only arrangement can only be a temporary concession.

I therefore think that it wasn't unreasonable that Pepper Money didn't extend the interest only arrangement any further. But when the mortgage switched back to repayment and Mr E struggled to afford that, it agreed to temporarily reduce the interest rate instead, to bring the monthly payments down to an affordable level. I think that's fair.

Mr E also complained at this time that Pepper Money recorded the interest only switch as an arrangement on his credit file. As I've set out above, it told him it would – including in the 2 September letter. And the reporting was accurate; Mr E was paying less than the amount required under his mortgage agreement – because he was only paying the interest, not the capital – but he was doing so with Pepper Money's agreement. He was in an arrangement, and it's fair Pepper Money reported that to his credit file.

Putting things right

I don't think Pepper Money is required to switch the mortgage to interest only permanently, and I think it has offered fair forbearance, for the reasons I've explained. However, it's clear that the misinformation in the December calls did cause Mr E upset when he discovered he'd been misled. I agree with our investigator that £300 is fair in all the circumstances.

My final decision

My final decision is that Pepper (UK) Limited trading as Pepper Money should increase its offer of compensation to £300.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr E to accept or reject my decision before 26 February 2024.

Simon Pugh
Ombudsman