DRN-2683261

The complaint

Mr S complains that the consolidation loan he took out with Step One Finance Limited was unaffordable. He asks that fees and interest are refunded, with interest.

What happened

Mr S took out a loan with Step One in late 2015 for about £42,500. The loan was secured by a second charge on his house. He used most of the proceeds to repay existing secured and unsecured debts. Mr S says Step One should have seen from his high level of borrowing that even with the loan he would still struggle to repay the loan sustainably. He said Step One should have made better checks, and the number of short-term loans he'd taken out should have alerted it to a problem. He said at that time his mental health wasn't in a good place.

I sent a provisional decision to the parties to set out what I thought about this complaint. In summary, I said the information Step One had about Mr S's credit commitments and credit history should have alerted to a possible problem and the need for more checks. I said if Step One had carried out more checks it would have seen the risk that this loan might adversely affect Mr S's financial situation. I said Step One should refund some of the interest and charges paid by Mr S and remove adverse information about the loan from his credit file.

Step One didn't agree. It sent detailed comments about why it thought its checks were adequate.

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.

Step One sent detailed comments in response to my provisional decision. I won't set out its comments in full here, but I have of course read them and taken them into account.

Mr S took out the secured loan with Step One in November 2015. The loan was regulated by the Consumer Credit Act 1974. Before offering the secured loan to Mr S, Step One had to assess the potential for commitments under the agreement to adversely affect his financial situation. It had to consider enough information to enable it to make a reasonable creditworthiness assessment. The scope of this was dependant on and proportionate to the circumstances. This might include the amount of the loan, Mr S's financial circumstances, his existing commitments and his credit history – including any indications of financial difficulties.

Step One asked for evidence of Mr S's income. It asked Mr S for information about his living costs, existing indebtedness and debt repayments, and did a credit check. I've reviewed the information Step One received from its credit check.

Mr S had a mortgage of about £94,000. He had a loan of about £14,000 (which he'd taken out in August 2015), and another loan with a balance of about £9,000. He had five credit card accounts with balances close to their credit limits. He had three current accounts, two of which were overdrawn close to the limit, and a mail order account. And he had what appear to be six short-term (payday) loans, most taken out within the previous two months. The results of Step One's credit check showed previous use of payday loans.

I think the information Step One had – in particular, Mr S's level of borrowing, that he'd taken out a personal loan only three months before and his use of payday loans – should have alerted it to the risk Mr S had financial difficulties.

Step One says it assessed the repayments as affordable, based on the information it had about Mr S's income and outgoings. But Step One needed to do more than a simple pounds and pence calculation. It needed to check that Mr S could repay the loan sustainably and without adverse effects on his financial position. I think there were clear indications here that Mr S was struggling to manage his money.

I think Step One should have declined to lend or asked for more information to review Mr S's financial situation in more detail. Had it looked at Mr S's bank statements it would have seen payments to a number of lenders, including payday lenders. I don't agree with Step One that Mr S's use of short-term loans only suggests this was Mr S's chosen method of liquidity management. And I don't think it's right to say there can't be indications of financial difficulty because Mr S's repaid loans on time – particularly if he was taking out new loans to fund the repayment or the gap in his finances left after he repaid loans. I think Mr S's use of credit and short-term loans suggests he was having significant difficulty managing his finances and was reliant on short term credit.

Mr S hasn't said he had a gambling problem, and I'm not suggesting he told Step One this. However, his bank statements show payments to on-line gambling businesses which could suggest a gambling problem – especially given what Step One knew about his high levels of debt and use of short-term loans.

I think there were clear indications of financial difficulties that should have prompted Step One to look carefully at Mr S's circumstances. Had Step One carried out proportionate checks, it would likely have been alerted to a possible gambling problem, and the risk that further borrowing would adversely affect Mr S's financial situation. In particular, that he would use any additional borrowing for gambling. In fact, this is exactly what happened: Mr S transferred about £4,000 to gambling businesses within two weeks of taking out the loan.

I'm not suggesting that Step One could have controlled what Mr S did with the loan funds once he had them. But I think it would likely have been aware of the risk Mr S would use the loan proceeds for gambling if it had carried out proportionate checks.

By taking out the loan and using the proceeds to repay some of his existing debts Mr S was able to reduce his monthly debt repayments. Step One repaid six loans (totalling about £36,000) directly. If Mr S had used the remaining £4,000 of the loan proceeds to repay some loans and overdrafts he'd still have been left with about 15 loans outstanding (albeit some with a balance of less than £500, according to Step One). And given the pattern of gambling in Mr S's bank statements, there was an obvious risk this is how he'd use the funds – putting him in a worse position, especially as this loan was secured on his house.

I agree that taking out the loan and using the proceeds to repay some existing debts reduced Mr S's monthly debt repayments. I've taken this into account when deciding what Step One should do to put matters right. But I think any potential benefit of reducing monthly payments was outweighed by the very real possibility that further borrowing would adversely affect Mr S's financial situation.

Step One says there's no evidence the loan caused Mr S any detriment. But as I've said, Step One paid £4,000 into Mr S's bank account, and he'd transferred about £4,000 to gambling businesses within two weeks. He paid fees, charges and interest related to the loan. I think there were clear indications Mr S was might be in financial difficulty, and further borrowing was likely to make his financial situation worse, especially as this loan was secured on his home.

I don't think Step One should have offered this loan to Mr S. It doesn't change matters that Mr S has since repaid the loan: at the time he took out the loan it wasn't responsible for Step One to lend to him. So it needs to put matters right.

Putting things right

I don't think Step One should have offered this loan to Mr S. I think it should do the following to put matters right:

1. remove all fees and charges it applied to the loan (including its lender's fee, but not the broker's fee), and adjust the interest applied to the loan account accordingly.

2. I don't think Step One should have added the broker's fee to this loan, which put Mr S into a worse financial position. While Step One says adding the broker's fee to the loan was Mr S's choice, I don't think it should have offered the loan to Mr S. So paying interest on fees related to the loan isn't fair. I think Step One should adjust the interest applied to the loan account as if the broker fee hadn't been added to the loan.

3. I think there was an obvious risk that Mr S would use the funds Step One paid to him (about £4,000) for gambling, rather than to repay debts. So I think Step One should adjust the interest applied to the loan account as if the starting balance had been £4,000 lower.

4. About £36,000 of the loan was used to repay other debts. While this reduced Mr S's monthly debt payments, this doesn't necessarily mean the overall cost of the borrowing was reduced: this would depend on the interest rates and remaining term of the debts that were consolidated.

   I think there's a further complication here. If these loans were due to be repaid in the short term, I think Mr S would most likely have taken out further borrowing to fill the gap in his finances this would create – in effect extending the borrowing. This makes it difficult to calculate the true cost or benefit of consolidating these debts. And I need to take into account that Mr S would have paid interest on the debts that were consolidated.

   Overall, I don't think it's fair and reasonable to require Step One to refund interest on all of the loan (only as set out in 1 to 3 above).

5. Having adjusted the loan balance as set out in 1 to 3 above, Step One should deduct all payments made by Mr S into the account. If this results in him having paid too much, the overpayments should be refunded, with 8% simple interest from the date he repaid the loan to the date of settlement*.

6. Step One says it didn't record any adverse information on Mr S's credit file. To ensure my decision is complete, I will say that it should remove adverse information (if any) about the loan from Mr S's credit files.

Mr S hasn't said that the loan caused him additional upset or distress such that it would be fair and reasonable to order Step One to pay compensation for this.

*If HM Revenue & Customs requires Step One to take off tax from this interest, it must give Mr S a certificate showing how much tax it's taken off if he asks for one.

My final decision

My decision is that I uphold this complaint and order Step One Finance Limited to take the steps and make the payments set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr S to accept or reject my decision before 15 April 2021.

Ruth Stevenson
Ombudsman