

The complaint

Ms P complains that Evolution Lending Limited lent her a second charge mortgage (secured loan) that wasn't affordable for her, and resulted in her having to sell her property to repay it.

What happened

Ms P took out a second charge mortgage with Evolution, secured over her home, in 2017. She borrowed £10,000 plus fees of £1,800 at an interest rate of 30.6%, over a term of 15 years, paying £270 per month.

The loan was taken out to consolidate other debts, including an earlier unsecured loan taken from a sister company of Evolution which was itself used to consolidate debt including payday loans. It was also used to pay off arrears on her main mortgage.

Less than two years later, Ms P sold her property and repaid the loan. She said she felt she had no choice but to do this because the loan was unmanageable for her. She had missed payments and direct debits had bounced. She felt she could no longer continue with the loan.

Ms P complained. She said the loan was unaffordable for her and should never have been lent if Evolution had acted responsibly. She said she had limited income available to repay the loan and a history of credit problems, and she was in arrears on her main mortgage at the time. And she said that although she'd borrowed £10,000, the loan settlement figure was almost £14,500 – despite having paid over £3,000 in the meantime.

Evolution didn't agree it had done anything wrong. It said it had checked her income and expenditure and credit record. It said the loan was affordable. While Ms P had since missed some payments, it said it thought that was because of other circumstances – such as Ms P having been a victim of fraud – rather than because the lending was unaffordable. It said it had offered to support Ms P in her financial difficulties, but she chose to repay the loan.

Our investigator didn't think Evolution had lent responsibly, and said it should refund all interest charged to the loan. Evolution didn't agree, and asked for an ombudsman to decide the complaint.

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 order to decide this complaint, I've looked carefully at the lending decision Evolution took. I've reminded myself of the regulator's rules for assessing affordability and responsible lending, to be found in section 11.6 of the MCOB section of the FCA Handbook.

Although the loan was sold by a separate (though linked) firm, the obligation to assess affordability and whether it is responsible to lend falls on Evolution Lending as the lender.

In assessing whether to lend, Evolution was required to consider evidence of Ms P's income

and information about her expenditure. It may rely on information provided by Ms P unless, taking a common sense view, it has reason to doubt it. But it must take reasonable steps to obtain details of her committed expenditure, which it must corroborate from an independent source such as a credit file or bank statements. Where, as here, a loan is being taken for debt consolidation, the lender must take reasonable steps to ensure the debts are paid off or use them in the affordability calculation. The purpose of the affordability assessment is to ensure that the borrower is able to repay the loan – including taking into account possible future interest rate rises.

Evolution looked at the income and expenditure and fact find completed by the loan seller, and obtained payslips. I'm satisfied that it took a reasonable view of Ms P's income, supported by the evidence.

In looking at her expenditure, again it considered the income and expenditure and fact find, as well as Ms P's credit file. It also obtained a bank statement for Ms P's current account.

Ms P applied for a loan of £15,000 but Evolution decided that under its lending criteria the maximum loan she qualified for was £10,000 – though this was related to her credit history rather than affordability. Its criteria set a maximum lending cap based on credit history, within which an affordability assessment then takes place. In this case, Evolution lent the maximum Ms P qualified for. Most of the loan was for debt consolidation, including clearing the arrears on her main mortgage.

Having looked at the evidence, I'm not persuaded Evolution took a realistic view of Ms P's expenditure in relying on the fact find for the affordability assessment. It ought to have had common sense grounds to doubt what it had been told based on other information in its possession.

For example, the income and expenditure records that Ms P spent £240 per month on food and housekeeping – but the bank statement shows that she spent almost £500 in supermarkets in the month covered by the statement, as well as expenditure on eating out and takeaways. While some of that might be discretionary or one-off items, I can't see that Evolution considered whether that was actually the case, made enquiries of Ms P, or took steps to question whether £240 was a realistic amount.

It shows that Ms P was just over the limit of her overdraft both at the start and the end of the month shown on the statement – suggesting on the face of it that her income and expenditure were broadly the same. But the detail of what was shown on the bank statement shows this was not in fact the case.

There were significant one off items of money in and money out on the bank statement given to Evolution:

- Money in (£3,675)
 - £2,275 from the sale of her car
 - £1,400 from a payday lender
- Money out (£2,299)
 - £770 to a payday lender
 - £140 to a payday lender

- A second mortgage payment of £575 (a late payment for the previous month)
- £814 to a holiday company

If these items are disregarded as being one-off items, it means that rather than Ms P's bank account having the same balance at the start and end of the month (just over her overdraft limit), her expenditure would be over £1,400 more than her income. Of that expenditure, only a loan payment of £236 was being consolidated.

This means that disregarding one-off items of money in and money out, and disregarding the loan to be consolidated, Ms P's bank statement shows that her expenditure exceeded her income by around £1,170. Since this was information in Evolution's possession at the time of the underwriting assessment, I think this ought, on a common sense view, have led it to doubt – or at least take further steps to verify – the information about expenditure it used in determining whether the loan was affordable. For example, it could have asked Ms P about this expenditure. It could have asked for further bank statements to verify if this was an unusual month or an accurate reflection of her regular spending. Or it could have adjusted the figures used in the income and expenditure to determine affordability in light of the information in the statement. But I can't see that it did any of those things.

Although advice was given by a separate company, it was a linked company and Evolution has given us a copy of the advice letter as part of this complaint. I'm therefore satisfied it would have been aware of the purpose of the loan. The advice letter shows that as well as debt consolidation, Ms P intended to use part of the loan balance to buy another car. Knowing this, I'd expect the income and expenditure to take into account spending on the car she would buy – such as estimated insurance and fuel costs. But no expenditure was in fact included.

For all those reasons, I think the income and expenditure information Evolution used to assess Ms P's affordability significantly underestimated her expenditure. I have reached that conclusion using information provided by Evolution as part of this complaint, and which it had in its possession at the time of the lending decision.

And on that basis I'm satisfied that, based on information available at the time, it's more likely than not that the loan wasn't affordable for Ms P, and that Evolution didn't take reasonable steps to ascertain whether it was or carry out a sufficiently robust affordability assessment. And my conclusion that the loan was in fact unaffordable is supported by the fact that Ms P began to miss payments within four months of the loan being taken out. I'm not persuaded that this was because of fraud or any other new circumstances.

That is enough for me to uphold this complaint and say that Evolution should not have lent this loan. But there are further factors which lead me to question whether it was responsible to lend.

Ms P was consolidating unsecured debt which she had taken out very recently – a high cost personal loan three months earlier, and an escalating cycle of payday lending from another lender. And she had other payday loans which Evolution required to be cleared before it would lend.

I can see from her credit file that the loan to be consolidated was taken out three months earlier. The underwriting notes show that this loan, and a payday loan, were taken into account as being consolidated and that Evolution also wanted confirmation that another payday loan would be paid off before it would agree to lend.

But the bank statement shows that Ms P was in a cycle of payday loans – paying a lender off

and borrowing a higher amount the same day.

In my view, having taken out repeated payday loans and consolidating a loan which was itself a consolidation loan taken only three months earlier ought reasonably to have led Evolution to be concerned that Ms P was in a pattern of increasing debt. In addition to this, she was over her overdraft limit on her current account, and only prevented it increasing further in the month for which we have a statement by selling her car and taking a payday loan.

And that, coupled with what it ought to have considered about her expenditure exceeding her income even after consolidation, reasonably ought in my view to have led Evolution to question whether this loan would have been sustainable for her. And in those circumstances, I'm not persuaded that it was appropriate or responsible to allow Ms P to secure spiralling debt she wasn't managing to her property even if this loan had been affordable on the face of her income and expenditure.

In addition, I note that part of the purpose of this loan was to allow Ms P to clear arrears on her main mortgage. I find it difficult to accept that it was responsible to allow Ms P to exchange arrears on her main mortgage – at an interest rate of around 5% - for a secured loan of around 30% even if doing so would have been affordable. It remains mortgage debt, but much more expensive and increases Ms P's overall secured indebtedness and her outgoings on secured debt. The arrears on the main mortgage were relatively small at this time and in my view it would have been more appropriate for Evolution to have refused to lend for this purpose on the basis that it would have been better for Ms P to try to reach an arrangement with her main mortgage lender.

For all those reasons, I'm satisfied that this loan was irresponsible and unaffordable, and should never have been lent.

Putting things right

In those circumstances, I don't think it's fair and reasonable for Evolution to have charged Ms P interest or fees for lending she should never have been given. It's fair that she repaid the capital, since she had the benefit of that and if I were to ask Evolution to refund the capital too that would mean Ms P would effectively have the consolidated debts written off – which would leave her in a better position than she would have been in had this lending not happened.

I note Evolution's point that refunding the interest means it's possible Ms P is better off through my redress – in that I am directing interest to be refunded on the consolidated debt that Ms P would have paid had the debts not been consolidated. But it's also possible that had they not been consolidated into a secured loan, Ms P would have come to an arrangement with her creditors, or considered solutions such as an IVA – and if those loans had been defaulted or written off, she wouldn't have paid interest. It can't now be known what would have happened had Evolution not lent. I've taken into account what it has said, but it does not alter my conclusion that this complaint should be upheld, or my conclusion that it wasn't fair for Evolution to collect interest on a loan it shouldn't have lent.

In order to pay back this loan, Ms P had to sell her house. I don't think I can fairly hold Evolution entirely responsible for this. If it had never lent, given what I've said about Ms P's finances it's possible she would have got back into further arrears on her main mortgage and still had to sell her property at some point. But the loan from Evolution made that outcome more likely, and caused Ms P considerable upset as a result.

I told the parties that I think Evolution should pay her £750 compensation in recognition of

the upset and inconvenience caused by having to sell her house to repay the loan. Ms P accepted that. But Evolution disagreed. It said it thought £500 would be more appropriate. It said it was Ms P's decision to sell her property and it wasn't responsible for that – and as I've said she might well have had to sell in any case. It said that if either Evolution or her main mortgage lender had needed to repossess, there would have been additional costs associated with that which Ms P avoided by selling. And it also said that it should be taken into account that the other redress would leave Ms P in a better position than had the lending not happened and the other debts not been consolidated.

But I am satisfied that Evolution's decision to offer a loan that was unaffordable and secured to her property left Ms P with no option but to sell when she could no longer manage the loan. It's possible that might have happened anyway – though the arrears on the main mortgage were small when Evolution lent this loan – but in my view Evolution's decision to lend made it much more likely. I'm satisfied that £750 is fair compensation in all the circumstances.

Finally, I note that Evolution reported the total charge for credit, not the balance outstanding from time to time, to Ms P's credit file. And it reported that the loan had been defaulted on 20 February 2019.

I don't think this was appropriate. The total charge for credit is the total amount Ms P would pay if the loan had run to term. It was not the balance she owed on any given day. So Evolution should have reported the actual outstanding balance – not the total charge for credit – for the duration of the loan. It should also not have recorded a default. This is a regulated mortgage contract, not a consumer credit agreement. A consumer credit default notice is not appropriate on a mortgage. And a default should only be recorded on a credit file in respect of a mortgage when the mortgage is brought to an end through, for example, repossession – which did not happen here.

Ordinarily I would direct Evolution to remove the record of default and amend the reported balance. However, if Evolution had not lent, this loan would never have been recorded on Ms P's credit file in the first place. So rather than correct those mistakes, I simply require Evolution to remove the record of the loan.

My final decision

For the reasons I've given, my final decision is that I uphold this complaint and direct Evolution Lending Limited to:

- Calculate the total amount Ms P has paid in respect of this loan, including all fees, monthly payments and the redemption figure;
- Calculate the total amount of capital Ms P borrowed, disregarding interest and all fees whether charged by the lender or the seller;
- Pay Ms P the difference between those two figures, adding simple annual interest of 8%* running from 30 August 2019, when the loan was redeemed, to date of payment;
- Pay Ms P £750 compensation; and
- Amend Ms P's credit file so that the record of this loan is removed.

** Evolution may deduct income tax from the 8% interest element of my award as required by HMRC. But it should tell Ms P what it has deducted so that she can reclaim the tax if she's entitled to do so.*

Under the rules of the Financial Ombudsman Service, I'm required to ask Ms P to accept or reject my decision before 25 April 2023.

Simon Pugh
Ombudsman