Financial Ombudsman Service

The complaint

Mrs C complains that Step One Finance Limited irresponsibly lent her a second charge mortgage (secured loan). She says that Step One didn't carry out proper checks and didn't identify that she was spending compulsively on gambling which would have impacted her ability to repay the loan.

What happened

Mrs C took out her loan with Step One in August 2020. She borrowed around £30,500 including fees over 30 years at an interest rate of 8.9% fixed for five years, with a monthly payment of around £245. The purpose of the loan was to consolidate existing unsecured debt. Mrs C didn't approach Step One directly; the loan was recommended to her by a broker I'll call F.

Step One assessed the application. It noted that Mrs C had unsecured debt which she would be consolidating, but had no missed payments on either her main mortgage or her unsecured debt. It checked her income and expenditure and concluded the loan was affordable. As well as considering Mrs C's credit record, Step One also verified her income via payslips, and looked at one month's bank statement. Step One also spoke to Mrs C before agreeing the loan and asked her whether she had any health or other issues which would impact her ability to repay the loan – Mrs C said she didn't.

In 2022, Mrs C complained to Step One. She said the loan shouldn't have been given to her. She said that at the time she applied for the loan she had mental health problems and a gambling addiction. She'd since been unable to keep up with the payments. She said Step One should have identified this at the time of the lending decision and not given her the loan.

Step One said it hadn't lent irresponsibly. It had checked Mrs C's income, expenditure and commitments and the loan was affordable. It had asked her whether there were any issues impacting her ability to repay the loan and she had said there weren't. It had no reason to know of any health or gambling issues. It said Mrs C had taken out further credit since this loan, which may have contributed to her financial difficulties. But it wasn't responsible for that. It said it was willing to work with her to assist her in repaying the loan.

My provisional decision

I issued a provisional decision setting out my thoughts on the complaint. I said:

In reaching my view of this complaint, I've considered the rules of mortgage regulation as they were at the time, including the obligations on a lender to lend responsibly having carried out a full affordability assessment. I've taken into account what Mrs C, via the broker, told Step One as well as what Step One knew or ought to have known through its own enquiries.

Mrs C gave Step One her payslips. Her employment income appears accurately recorded. However, I understand Mrs C also owned a rental property at the time – the rental income (and any expenditure in relation to that property) is not included.

I’ve also considered what Mrs C said about her expenditure. Mrs C didn’t provide a copy of her bank statement, but she did provide a series of screenshots of her banking app. Step One has provided us with its underwriting file, showing a month’s worth of transactions.

In the month provided, there were payments to:

Description	Instances	Total
An e-money provider	16 payments on 6 days	£3,227.43
An e-money provider	4 payments on 2 days	£335.30
An e-money provider	7 payments on 2 days	£1,390.17
An e-money provider	13 payments on 4 days	£3,800.32
A cryptocurrency firm	3 payments on 1 day	£548.64

While there is nothing on Mrs C's bank screenshots to suggest any of these are payments to online gambling sites, I’m aware from evidence provided on another complaint Mrs C has brought to us that until gambling payments from credit cards were banned, Mrs C gambled using credit card funds. And once that ban was in place, she moved to using e-money providers.

As I say, there is nothing on the banking screenshots provided to Step One that suggests these are obviously gambling related. However, the screenshots do show that Mrs C was making regular, and very large – especially compared to her income – payments to e-money providers. In my experience, such a pattern of payments can be suggestive of gambling. And in any case, as a responsible lender considering whether this loan would have been affordable to Mrs C, I’d have expected Step One to have questioned what these payments were and considered whether such a size and frequency of payments were relevant to affordability – especially as they didn’t reflect Mrs C's declared expenditure.

The rules of mortgage regulation require a lender such as Step One to seek evidence of income, and information about expenditure. None of these payments, or any other matter of concern, was declared in Mrs C's expenditure form. The rules say Step One may rely on information about expenditure provided by Mrs C – unless, taking a common sense view, it has reason to doubt what it’s told. Based on the banking screenshot showing the expenditure I’ve set out above, which was information in Step One’s possession at the time, I’m satisfied there were, on a common sense view, good grounds for doubting the accuracy or completeness of the expenditure information it was given.

I’ve then gone on to think about what Step One ought, acting fairly in line with the rules, to have done in response to that doubt. In my view, it ought to have asked Mrs C to explain the transactions, and ought to have asked for further evidence of expenditure – such as bank statements going back more than one month.

I’ve said above that Mrs C has made another complaint about lending by her current account provider. As part of the evidence on that case, we have Mrs C's bank statements. They show that these transactions are not out of character – they reflect other transactions in the months before and months after the loan application.

Those statements also show that Mrs C was funding this expenditure in part by transfers from other bank accounts in her name, in part by transfers from people who appear to be family members (in which context, she told Step One that one of the debts to be consolidated was an £8,000 family loan) – and in part by borrowing elsewhere.

For example, the banking screenshots in the underwriting file Step One has sent us start on 18 June 2020. Mrs C's bank statements show she received £24,000 in an unsecured loan from another provider on 17 June 2020. This loan was not declared to Step One, was not in the list of loans to be consolidated by Step One's loan and – because it was so recent – did not appear on her credit file. But it would have been discovered, and taken into account, had Step One carried out the further enquiries it ought to have been prompted to by the content of the banking screenshots it did consider. Mrs C transferred around £15,000 of that loan to her other accounts, and used £6,000 to pay off a credit card.

The screenshots on Step One's file do show a payment of £7,500 into her account from another bank on 26 June 2020. The payment is in the name of the bank – not a customer of that bank – and I'm aware from the other case that this was in fact another personal loan taken out by Mrs C. This loan was not on the list of debts to be consolidated by the Step One loan. Despite this loan showing on the screenshots in Step One's possession, it does not appear to have questioned why Mrs C had taken it out so close to the Step One loan.

The screenshots also show a third personal loan with a different bank, again for £7,500, taken out on 6 July 2020. Again, Step One does not appear to have questioned this loan payment – even though it's on the screenshots that were in its possession at the time.

No expected payments for any of these loans – the two £7,500 loans taken out in July 2020 and the £24,000 loan taken out in June 2020 – appear on the expenditure information considered by Step One.

In my view, Step One ought to have been aware of both of the £7,500 loans. The payments into Mrs C's bank account showed on the screenshots it had. And it ought to have been aware of the £24,000 personal loan – since the e-money transactions ought to have led it to look more closely and at a longer period of Mrs C's bank statements.

In this connection, I note that the underwriting file Step One has given us only shows one months' worth of banking screenshots, as I've set out above.

However, Mrs C has given us an email from the broker, F, which says that Step One requires two months' bank statements not one. The broker comments "I have tried to override this point but they [Step One] won't budge". I don't know whether F didn't pass the statements on to Step One, or whether Step One changed its mind about needing them, or whether Step One received them but didn't consider them or include them in the underwriting file sent to us. But this is further evidence that Step One ought to have considered a wider picture than the one month's screenshots included in the underwriting file.

I don't think it's enough for Step One to say it relied on what Mrs C told it about her expenditure, and that she didn't declare any reasons why the loan might be problematic when it spoke to her. It's not enough to rely on what the applicant says alone when, as here, there were clear grounds, on a common sense view, for doubting it. Nor is it enough to say that Mrs C's financial difficulties were caused by her taking out other loans around the same time as this loan rather than by this loan – that may be true, but as I've set out, Step One knew or ought to have known about those other loans and should have taken them into account in deciding whether to lend.

Step One ought to have considered these loans not just from the point of view of whether the monthly payments on those loans would make this loan unaffordable, but also whether they were suggestive of a spiral of debt Mrs C wasn't managing – which is relevant to the broader question of whether this loan was sustainable and whether it was responsible to lend. It's difficult to see any other reasonable explanation for Mrs C consolidating £30,000 of debt with this loan, and also having taken out another £39,000 of debt weeks before this loan completed.

Step One also says that it only requested, and considered, Mrs C's banking screenshots for the purpose of verifying her income. That may well be the reason why it requested them. But I don't think it's reasonable to say that once it had them in its possession, it should have ignored the other information they contained when that information ought to have given Step One considerable concern about whether it was appropriate to lend.

I'm therefore satisfied that there was enough information in Step One's possession – the e-money expenditure and the two £7,500 loans – that ought reasonably to have led it to conclude that the expenditure information it used to determine affordability wasn't accurate, and that this loan might not be sustainable for Mrs C. And that information ought reasonably to have led it to make further enquiries, which would have revealed both the £24,000 loan and that the expenditure was not isolated.

Step One says that Mrs C has largely been managing this loan – which shows it wasn't unaffordable. But I don't agree about that. She has missed payments – including taking a coronavirus payment deferral almost immediately after taking it out. And she's explained that she's (rightly) prioritised this loan as one secured over her property while taking debt advice and reaching arrangements with her unsecured creditors. Had Step One not lent this loan, she would have had the chance to do that with the unsecured debt consolidated into it too.

In my view, Step One ought reasonably to have considered the information I've set out above which was in its possession or which it ought reasonably to have obtained. Having done so, it ought reasonably to have taken into account the e-money expenditure and the monthly payments for these three personal loans. And had it done so, I'm satisfied that – acting fairly as a responsible mortgage lender – it would have concluded that this loan was not affordable or sustainable for Mrs C, and as a result it would never have lent. It follows that Step One lent irresponsibly.

To put matters right, I don't think it would be fair to say Step One should write off the loan balance – Mrs C borrowed this money and had the benefit of it. It appears the loan was not used directly for gambling transactions; rather, it was used to repay existing unsecured debt and I've no evidence that unsecured debt was itself irresponsibly lent.

Instead, Step One should treat all payments Mrs C has made to date as payments towards the capital. It should remove all interest and fees it has charged, including the initial lender application fee. I don't direct Step One to remove the broker fee, since it didn't charge that fee and the broker was already involved before the application to Step One was made. Any complaint about the fee charged by the broker would need to be dealt with in a separate complaint to the broker.

This will reduce the outstanding loan balance to around £24,000. Step One should then work out the monthly payment Mrs C needs to make over the remainder of the term to repay the remaining capital – with no further interest or fees being charged. It should also remove any information about this loan from Mrs C's credit file. Step One will also need to act fairly and sympathetically in recovering the outstanding capital from Mrs C in the event the reduced monthly payment of capital only is unaffordable for her.

Finally, I think this lending decision caused Mrs C substantial upset by adding to her indebtedness – and securing it over her property, which makes it more difficult for her to reach the same sort of arrangement she's reached with other creditors. I think £500 is fair compensation for the resulting distress and inconvenience in all the circumstances.

The responses to my provisional decision

Mrs C asked me to consider directing Step One to write the loan balance off. She said she did use the money she borrowed for gambling rather than consolidating debts – the debts that she was supposed to have consolidated ended up being included in her arrangement with her unsecured creditors. She says that as a result she didn't have the benefit of what the loan was intended for. The loan is secured against her home but should never have been lent.

Step One didn't agree with my provisional decision. It provided further evidence which it said showed:

- It increased the expenditure it considered in its underwriting assessment following a review of Mrs C's bank screenshots, and questioned some of the information it found. In particular, it asked about the money going out of the account, and Mrs C told it that the money related to a fundraising campaign she was running for the benefit of the family of a recently deceased friend. She provided evidence of the online fundraising campaign and Step One verified it for itself.

- Step One therefore did check the information Mrs C provided. It had no reason to know that she was in fact paying substantial sums to gambling companies via e-money providers. It said it didn't enquire further into the fundraising because doing so would be "insensitive and potentially inappropriate".

- All the debts Step One knew about were consolidated into this loan. It believes Mrs C deliberately concealed the most recent borrowing by not declaring it in the application, and because it was so recent Step One could not have seen it on her credit file.

- One of the recent £7,500 loans was later recorded on Mrs C's credit file as having been repaid 11 days after it was taken out, and before the Step One loan completed.

- It has not been able to find any evidence of a second £7,500 loan on her credit file, so questions whether that payment was a loan at all, or whether it was also repaid within a short time and so didn't appear on Mrs C's credit file at all.

- It now appears the £24,000 was not a personal loan but a further advance on a mortgage secured on a different property – Mrs C had not declared her ownership of this property or the associated mortgage on her application. And according to Land Registry and credit file records she sold that property in 2021, realising £60,000 of equity none of which was used to pay this loan.

- Step One said it did not see this loan at the time because it was not recorded with the particular credit reference agency it used. It only discovered the existence of this property in 2021 when Mrs C said she would use part of the sale proceeds to repay coronavirus payment deferrals. The checks it carried out at the time of lending were reasonable, and didn't allow it to discover this loan.

- Step One does not agree it can be held responsible where a customer has concealed or withheld information. And to uphold a complaint in such circumstances risks encouraging application fraud.

- Step One does not think it appropriate for me to consider evidence received by the Financial Ombudsman Service in respect of another complaint.

- Step One said it made a reasonable underwriting decision based on the information it had at the time – including a clean credit file with no gambling activity visible, reasonable expenditure and a reasonable explanation for large payments.

- It said it was willing to offer Mrs C reasonable forbearance if she is in financial difficulties. But it did not agree that this complaint should be upheld.

Mrs C said the fundraiser raised around £1,200. I've checked and when it ended the total was around £1,700, so this is consistent with it being at around £1,200 at the time of the lending decision. We asked Mrs C to provide statements or transaction histories from the e money providers but she was unable to do so. She said she didn't tell Step One about the other property because she was worried the loan would be turned down. She said she was in a bad place with a gambling addiction at the time, and Step One should have done more checks to stop her taking out the loan. She said the further advance on the mortgage was also spent on gambling.

More recently, Mrs C said, she has recovered from her addiction and got her finances back under control. She now only has the main mortgage and this loan secured on her property, and her unsecured debt is in a debt management plan. She hasn't made any payments to this loan pending the resolution of this 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.

I've also reconsidered my provisional findings, and taken into account the further evidence and argument that has been provided since.

I don't agree that it's not reasonable to take into account evidence we've been provided with on another complaint, if it's relevant to this complaint. In this case, the evidence I was referring to isn't directly relevant to Step One's lending decision, since it pre-dates that decision. But the evidence – Mrs C's bank and credit card statements – corroborates her account that she made extensive payments to gambling websites which, by the time of this loan, had been replaced with payments to e-money providers rather than direct to gambling sites.

And they are evidence that, if it had acted on the common sense doubts it ought to have had based on the information in its possession, it would have obtained itself at the time. I based my provisional decision on information Step One did have – or ought reasonably to have had, if it had made the further enquiries I think it ought reasonably to have made.

It did have one month's worth of screenshots from Mrs C's bank account. And I remain satisfied that it ought to have considered these, and that the information contained in them ought – on a common sense basis – have led it to question what Mrs C had said.

Step One says it checked the online fundraiser itself, and has provided a screenshot it took of it. I don't know the precise balance at the time (it hasn't provided that part of the screenshot), but it must have been no more than the £1,700 that was the final total. This cannot therefore explain the more than £9,000 in payments the banking screenshots showed to e-money and cryptocurrency providers. And I don't think that Step One considered this to be a sensitive matter was a reasonable explanation for not enquiring further into this discrepancy.

And while the other property and mortgage might not have shown up on the particular credit reference agency Step One used at the time, the £24,000 further advance did show on the banking screenshots Mrs C had, as did one of the £7,500 loans. One of those loans might have been paid off before the Step One loan completed – but that is something Step One has discovered now, not something it took into account at the time. Had it asked Mrs C for further information about her finances in light of the questions it ought reasonably to have asked having considered the banking information it had, I think it ought reasonably to have discovered the other loan too.

Overall, I'm satisfied that there was enough information in Step One's possession at the time it made the lending decision that ought reasonably to have led it – on a common sense basis – to question whether the information it had been given was accurate. It ought reasonably to have led Step One to make further enquiries, which would have led to it discovering further matters of concern – including Mrs C's recent additional indebtedness which she hadn't declared, as well as her high spending to e-money providers. Taking into account what it knew or ought to have known, I think it ought reasonably to have substantial concerns about the accuracy of what Mrs C had told it, and it ought reasonably to have questioned whether this loan was affordable or sustainable for her. In my view, taking those factors into account, it wasn't – and it follows that Step One didn't lend responsibly.

I've also considered Step One's point that it seems Mrs C actively concealed, or didn't declare, some of these matters despite being asked about her income, expenditure and debts as part of the application. I understand its concerns about this. But separate to Mrs C's obligations to give accurate information, Step One had its own obligations. It had to consider the information it did have, and while a lender is generally entitled to rely on information about expenditure it's given by an applicant, it shouldn't do so without further checks if there are common sense grounds for doubting it – as there were here.

Even if Mrs C didn't give Step One a full picture in making her application, it still ought to have checked what it had been told carefully, and if it had done so it would have discovered many of the matters I've set out. That's one of the reasons underwriting checks are important. Had it acted on the information it had in its possession, it wouldn't – acting fairly – have lent.

However, I don't think it would be fair to write off the loan balance. It wouldn't be fair for Step One to recover interest on, or fees for, a loan it should never have lent. But it did lend the capital to Mrs C and it's fair and reasonable that she pays it back.. I understand Mrs C feels that she didn't benefit from the loan in the sense that it, or the debts it repaid, were largely spent on gambling. But she did receive the money and make use of it, and it repaid debts she already had – without this loan she would still have had those debts. I think it's fair and reasonable that she repays what she borrowed – but that Step One shouldn't be entitled to charge interest on money it shouldn't have lent.

Putting things right

To put things right, Step One should remove all interest, and all fees it has charged including the lender application fee which were added to the loan balance, and not charge future interest. It should treat all payments Mrs C has made to date as being payments to capital reducing the balance. It should then contact Mrs C to reach an affordable payment arrangement for the outstanding balance.

Mrs C will need to co-operate with this process and provide information about her income and expenditure as the remaining capital balance will remain secured over her property and will need to be repaid.

Finally, Step One should remove all records relating to this loan from Mrs C's credit files, because had it acted fairly the loan would not have been lent – so it wouldn't be fair for her credit file to reflect lending she shouldn't have been given. And it should pay Mrs C £500 compensation for the distress and inconvenience caused by its lending decision – I've taken into account that Mrs C clearly wanted this loan and took steps to improve her chances of getting it. But nonetheless it should not have been lent to her, and its existence has made it more difficult for her to resolve her overall financial problems than would have been the case had the debt it consolidated remained unsecured.

My final decision

My final decision is that I uphold this complaint and direct Step One Finance Limited to put matters right in the way I've set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs C to accept or reject my decision before 6 October 2023.

Simon Pugh
Ombudsman