DRN-4404022

Financial Ombudsman Service

The complaint

Mr H complains that Evolution Lending Limited irresponsibly lent him a second charge mortgage (secured loan).

What happened

In 2019, Mr H took out a second charge mortgage with Evolution. He borrowed money to consolidate and repay existing debts elsewhere. He borrowed around £14,000 including fees over a term of ten years at an interest rate of around 27%, giving a monthly payment of around £300. Around £11,000 of unsecured debt – a mixture of loans and credit cards – was included in the loan.

In 2022, Mr H complained. He said that the lending was irresponsible and unaffordable, and he should never have been given the mortgage. Evolution didn't agree. It said that it had checked his income and expenditure, and the lending was affordable. It significantly improved Mr H's circumstances because his monthly expenditure on the debts consolidated into the mortgage reduced from around £960 to the £300 payable on this loan. It said that since taking out the loan Mr H had never been in arrears, which did not suggest it was unaffordable for him. Evolution said it had more recently been contacted by an insolvency practitioner because Mr H was planning to enter into an individual voluntary arrangement (IVA) – but it appeared this was because Mr H had taken out further finance since this loan, and Evolution wasn't responsible for that.

Our investigator didn't recommend upholding the complaint. She said that Evolution had carried out a reasonable assessment of Mr H's circumstances, and he had in fact been able to maintain payments on the loan. Mr H didn't agree and asked for an ombudsman to review his complaint.

My provisional decision

I took a different view, concluding that the complaint should be upheld. I issued a provisional decision in which I said:

> As the lender, Evolution is required to consider whether it is responsible to lend. This includes considering whether it is affordable – and whether it is sustainable for Mr H.
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> Evolution carried out an assessment of Mr H's income and expenditure. I've reviewed the information it took into account, and I have some concerns about whether the loan really was affordable for Mr H.
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> Evolution recorded his income as being around £2,275 per month, and his expenditure – excluding the debts to be consolidated into this loan – as being around £1,950 per month. This left around £325 per month surplus, which led Evolution to conclude the loan was affordable.
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> However, affordability should be considered not just at the moment of lending, but throughout the term. The monthly payment on this loan was around £300 – which

took virtually all Mr H's surplus income. But the interest rate was variable, meaning it could increase in the future, and there was little surplus expenditure to absorb that.

That's a particular issue in my view in this case, because part of the income Evolution took into account, alongside Mr H's salary, came from child benefit and child tax credit.

Mr H says Evolution shouldn't have taken this into account, because the children were his step-children not his natural children. I don't think that makes a difference, since they were part of his household and his family. I think the difficulty arises from the ages of the children – at the time of the lending, they were aged four, 14 and 17. The loan was over a ten year term, meaning that up to a third of Mr H's income would no longer be available by the end of the term.

Evolution said it explored this with Mr H, and he said he had another property which he might rent out to replace this income. But he also said that the property was currently vacant and then would be occupied by a family member, not rented out. There was no consideration of whether it was practical or plausible for Mr H to rent this property out at some time in the future, when that might be, or how much rental income it might generate. I'm not persuaded that this was something Evolution ought to have assumed was definitely in place or sufficient to replace the lost benefit income as the children reached the age of 18.

I think Evolution ought also to have been concerned about Mr H's credit history. It had a copy of his credit record, which I've also seen. It shows a long history of taking out short term lending, payday loans and other forms of credit. That included several loans taken out in the year before this application.

This application was the third time Mr H had taken out a secured loan with Evolution in eight years – the first was consolidated into the second, and the second was paid off very shortly before Mr H applied for this loan.

Since taking out the second Evolution loan in 2014, Mr H had defaulted on a series of debts in 2015. Some of those defaults – with a combined value of almost £5,000 – were still not settled at the time of this application. Mr H told Evolution he hadn't been contacted by those lenders and wasn't intending to contact them. But he could have been subject to debt collection action at any time.

And since the 2015 defaults, from 2017 onwards, Mr H had begun to build up unsecured credit again, leading to this application for a further consolidation loan.

I think this ought to have led Evolution to question whether a further debt consolidation loan was sustainable for Mr H. Evolution says that it substantially reduced his monthly outgoings, and that's true (though as I've said above there are concerns about whether even this lower amount really was affordable for him over the whole term). But it also secured those debts to his property at a relatively high interest rate. I think, given the history, that Evolution ought to have been concerned about whether the pattern of consolidating debt then running it up again would be repeated – and whether, as a result, repaying this loan would be sustainable for Mr H.

Evolution says that Mr H didn't in fact miss any payments after the loan was taken out. And that's correct. But Mr H did go on to run up further unsecured debt, leading to an IVA in 2022 – suggesting that the pattern did in fact recur. I don't think the fact that Mr H hasn't missed a payment in the first three years of the loan necessarily means that it was sustainable for him over the term; while he has so far prioritised his secured debts, his unsecured debts had reached the point at which he could no longer sustain them and if the IVA didn't resolve matters there would be a risk to the secured loan too.

Clearly Evolution couldn't have known specifically what would happen at the time it lent in 2019. But – having considered Mr H's credit file – it ought to have been concerned that he had an unsustainable relationship with debt, some of which was now being secured to his property by this loan. If similar patterns of securing unsecured debt to an Evolution loan, then running up further unsecured debt and either defaulting on it or consolidating it again, were to be repeated, that could mean Mr H might run into difficulties managing this loan too.

Taking all of that into account, I think there was enough to say that Evolution ought to have considered that there was a substantial risk that this loan wouldn't be affordable or sustainable for Mr H throughout its term. And in light of that I don't think it ought, acting fairly and responsibly, to have lent.

To put things right, Evolution should remove all interest, and the fees it charged, from the loan balance. It should treat all payments Mr H has made to date as being repayments of capital. It should then re-calculate the outstanding balance and reach a sustainable arrangement with Mr H for the repayment of the remaining outstanding capital balance. It should also remove any adverse entries associated with this loan from Mr H's credit file.

The responses to my provisional decision

Mr H said that he'd already repaid more than the original capital he'd borrowed, and that should be refunded to him.

Evolution didn't agree that the complaint should be upheld. It said:

- It carried out a full affordability assessment, including stress test, and concluded the loan was affordable for Mr H. It said his disposable income – even after allowing for discretionary expenditure and a contingency allowance for the outstanding defaulted debts – was higher than I'd noted in my provisional decision.

- It noted that the benefit income wouldn't be available to Mr H for the full term, but discussed this with him and Mr H confirmed he would be renting out his property. It therefore gave proper consideration to affordability throughout the term, and was entitled to rely on what Mr H had said. It's likely rental income would exceed the lost benefit income.

- Mr H had cleared most of the defaults from 2015, and only three remained outstanding. Evolution agreed that Mr H could have been subject to collection action at any time, and it allowed for payments to these creditors in its affordability assessment.

- While Evolution accepted that Mr H had a history of short-term lending, it discussed this with him at the time of the application, and he gave plausible answers. Evolution's business model involves lending to customers with poor credit history and just because someone has a poor past history, that doesn't mean they will struggle to manage their commitments in the future. If Evolution assumed that, it would be unable to lend and that would create "financial exclusion".

- It fully considered Mr H's circumstances, and the loan cleared Mr H's outstanding debts, which benefitted him. If Mr H went on to take out further credit, Evolution is not responsible for that or the consequences which followed. Mr H had maintained payments in full throughout the period between the start of the loan and his 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 considered the further arguments Evolution has made, but I haven't changed my mind. The figures for affordability I quoted in my provisional decision were taken from the income and expenditure assessment Evolution carried out at the time, so I think it's reasonable to take them as the basis for considering whether the loan was affordable.

It's correct that, when asked about his future income, Mr H said he could rent out the other property to replace the income lost from benefits as the children passed the age of 18. Evolution was required to take into account the future reductions in income as part of its affordability assessment. And while it could have taken into account future increases too, I think to do so there needs to be an assessment of the amount and credibility of that future income. I don't think a vague suggestion that Mr H might be able to rent out a property – currently occupied by family members – at some point in the future without consideration of how likely that was or how much income it might generate – is sufficient to be relied on as good evidence of future income replacing the lost benefits.

I'm not persuaded that lending as a form of financial inclusion is something relevant for me to take into account. Whatever Evolution's business model or risk appetite, it's required to lend responsibly and I think that's the key consideration.

Responsible lending doesn't just require an assessment of affordability; it's also about whether the loan will be sustainable. And while Evolution isn't responsible for Mr H's decision to take out further credit after consolidating his debts into this loan, I do think his patterns of doing so in the past were something that Evolution ought to have taken into account. To my mind, that suggests there's an increased risk that Mr H will fall back into the same patterns. As a responsible lender acting fairly, I'd expect Evolution to take into account whether further debt consolidation into this loan is likely to put Mr H into a position where his overall indebtedness increases to an unsustainable level. This is not just a question of Mr H making unwise decisions; if it was foreseeable that he might do so and that would impact the sustainability of this loan, that is something Evolution ought to have considered.

For all those reasons, and the reasons I gave in my provisional decision, I remain of the view that this complaint should be upheld.

Putting things right

To put things right, Evolution should remove all interest, and the fees it charged, from the loan balance. It should treat all payments Mr H has made to date as being repayments of capital. It should then re-calculate the outstanding balance.

If this results in a balance outstanding, Evolution should reach a sustainable arrangement with Mr H for the repayment of the remaining outstanding capital balance. If, however, this means that Mr H has already repaid more than the capital he borrowed, the excess should be refunded to him, adding simple annual interest of 8% running from when any payments above the total capital amount were made to the date Evolution refunds them. In this scenario, Evolution may deduct income tax from the 8% interest element of my award, as required by HMRC – but should tell Mr H what it has deducted so he can reclaim the tax if he is entitled to do so.

Evolution should also remove any adverse entries associated with this loan from Mr H's credit file.

My final decision

My final decision is that I uphold this complaint and direct Evolution Lending 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 Mr H to accept or reject my decision before 17 November 2023.

Simon Pugh
Ombudsman