DRN-4461764

The complaint

Mr K complains that Freedom Finance Limited mis-sold him a second charge mortgage (secured loan).

What happened

In September 2019 Mr K contacted Freedom Finance to discuss taking out a secured loan. He wanted to explore consolidating existing unsecured debt to reduce his outgoings.

At this time Mr K had a personal loan and a car finance agreement. The car finance agreement was due to end in 2024, and was at an interest rate of 10%. The personal loan would run until 2023 and was charged at 5%. The combined monthly payment to both loans was around £534.

Freedom Finance recommended a loan to Mr K. However, following the valuation of this property this loan was no longer available, so Freedom Finance recommended a new loan with a lender I'll call E. This loan was for £22,500 over a term of 20 years on a repayment basis, with an interest rate of 12.5% fixed for the first five years and a monthly payment of £282.77. Included in the loan amount were a broker fee of £1,350 and a lender fee of £995. The secured loan therefore reduced Mr K's monthly outgoings by around £250 per month.

In 2022 Mr K complained. He'd experienced problems maintaining the monthly payments on the loan. While this was because his circumstances had changed following the loss of his job, he said he'd come to realise the loan was never appropriate for him. He said he wasn't in the right frame of mind at the time he took it out because of personal circumstances. He said that he'd exchanged loans which would have been paid off within a few years for a much more expensive loan over 20 years – and which was secured on his property.

Our investigator thought the complaint should be upheld. He said that the loan wasn't suitable for Mr K or his circumstances, and that Freedom Finance should have carried out further checks before making the recommendation – had it done so, it wouldn't have advised Mr K to take the loan out.

Freedom Finance didn't agree and asked for an ombudsman to review the complaint. Having considered matters afresh, I agreed with our investigator that the loan wasn't suitable and shouldn't have been recommended. But my reasons for saying that, and the redress I proposed, were different. So I issued a provisional decision to invite any further comment or evidence from the parties. I'll set out my provisional findings and the replies to it below and then make a final decision.

My provisional decision

I said:

> "Alongside this case, I've also considered Mr K's separate complaint about E and its decision to lend to him. Having considered both complaints together gives me a good overview of all the circumstances that led to Mr K taking out this loan.

The purpose of this loan was debt consolidation, and Freedom Finance was advising Mr K. That means it was required to make sure that the loan was suitable for his needs and circumstances. And, as a debt consolidation loan, it was also required to take account of the additional costs associated with increasing the repayment period; the appropriateness of securing unsecured debt; and – if a customer has payment difficulties – whether it would be appropriate to come to an arrangement with unsecured creditors instead of taking an unsecured loan.

There's no evidence Mr K was experiencing payment difficulties at the time of taking this loan (though he did later, that couldn't have been foreseen at the time and resulted from a change of circumstances). But consolidating his unsecured debts did make them significantly more expensive.

Freedom Finance doesn't appear to have obtained full details of the personal loan or car finance loan it recommended consolidating. So I don't know the specific interest rates. But it appears that both were lower than the 12% charged on the secured loan – Freedom Finance estimated 5% for the car finance loan – and both had terms of less than five years remaining, compared to a twenty year secured loan.

This made consolidation significantly more expensive overall. By increasing the interest rate, and quadrupling the term, Mr K would pay much more to repay these debts had he not consolidated them.

There's no doubt that Mr K did want to consolidate his debts, and that was his purpose in asking for this loan. He wanted to reduce his monthly payments, and the loan achieved that.

But making a suitable recommendation isn't just a question of giving a customer what they want; it involves an objective assessment of their needs and circumstances and – taking into account the overriding objective of treating them fairly and taking account of their best interests – making a recommendation of the most suitable product to meet those needs and circumstances. This includes advising a customer not to proceed if there is no suitable loan available. And the assessment of suitability should be based on facts disclosed by the customer and any other relevant facts the firm is or should reasonably be aware of. The firm may rely on information provided by the customer unless, on a common sense view, there is reason to doubt it.

Mr K says that he was going through a difficult time when he took out the loan. In 2017 he'd had a car accident, and it had come to light in January 2019 that he'd suffered a minor brain injury as a result. Also in 2019 he and his partner separated. Mr K believes that because of the stress of his situation, combined with the effect of the medication he was taking, he wasn't making rational long term decisions. There's no suggestion that Mr K formally lacked mental capacity at this time, and I don't have medical evidence suggesting an impairment to his decision making. But nonetheless I've borne in mind what he's said about the difficulties he faced at the time and the impact of that on him.

I don't think Freedom Finance was aware of Mr K's difficult circumstances at the time – though there were opportunities during its conversations with him when it could have explored this but chose not to, Mr K also suggested any problems he'd had were now behind him. So while Mr K's circumstances are relevant as part of the background, I don't think it would be reasonable to say they are something Freedom Finance ought to have taken into account when giving advice.

Freedom Finance was aware of Mr K's financial circumstances. He'd taken out both the personal loan and the car finance in April 2019, about six months before this advice. He'd also re-mortgaged, increasing his borrowing, around the same time.

Freedom Finance also had Mr K's bank statement for his current account. As our investigator pointed out, this showed that Mr K's expenditure substantially exceeded his income. Mr K transferred money into his current account to cover the additional expenditure – but Freedom Finance didn't question this, or ask to see his other bank statements to verify this. I think it ought reasonably, taking a common sense view, to have questioned this level of expenditure and how it was being supported – but it didn't do that.

Our investigator did do so, and found that Mr K had substantial savings at the time of this loan – savings which were rather larger than both this loan and the debts it consolidated. The savings appeared to have come from a combination of a compensation payment from Mr K's accident and the borrowing he'd taken out earlier in the year. Had Freedom Finance looked further into Mr K's circumstances – as I think it should – it would have discovered this.

It was aware that Mr K did have some savings, but doesn't appear to have asked him how much. Mr K said he was intending to use the savings for home improvements. But Freedom Finance didn't discuss this in any more detail with him, or question whether it was appropriate to consolidate his debts when he could have repaid them, in full or in part, from his savings. I would have expected Freedom Finance at least to have made further enquiries about the level of his savings and his home improvement plans to have considered whether taking this loan was suitable for his circumstances. The existence of these substantial savings also leads me to question whether a relatively small reduction in his outgoings really was necessary for Mr K.

When Freedom Finance told Mr K about the loan it had arranged, including the interest rate and the overall cost of credit over the 20 year term, Mr K was concerned about how expensive this loan would be. Freedom Finance reassured him on the basis that he wouldn't keep the loan for the full term in practice. I don't think that was appropriate.

It appears this was because Mr K had suggested he intended to sell his car to reduce the balance shortly after taking the loan out. This would have been possible, since the loan terms didn't restrict overpayments. But if that was his plan, to my mind that ought to have led Freedom Finance to question whether he needed to take this loan out in the first place. If Mr K intended to repay his car finance with this loan and also sell his car to reduce the balance of this loan, I find it difficult to understand why Freedom Finance didn't question why he needed this borrowing – since he could have sold the car and paid off the car finance directly without the need to take out this loan first. But there wasn't any discussion of that.

I'm not persuaded that at the time he took out this loan, and based on his circumstances at the time, it was suitable for Mr K. Consolidating these loans substantially increased the overall cost of repayment, as well as securing them to Mr K's home. I'm not persuaded that, at the time of the advice, there was a pressing need for Mr K to consolidate his debts or that the savings – judged against his wider circumstances – outweighed the costs and risks of doing so. And I don't think Freedom Finance explored the alternatives to consolidation before concluding that this was the most suitable way forward.

I'm therefore intending to uphold this complaint.

Putting things right

Putting things right is not straightforward. My starting point is that I put Mr K back in the position he would have been in had unsuitable advice not been given. However, that's not possible in this case – suitable advice would have been not to proceed, which means Mr K would have retained the unsecured lending and not taken the secured loan. I cannot recreate that position.

Mr K's financial loss from the unsuitable advice is the difference in the cost of repaying the debts consolidated compared to the cost had they not been consolidated. However, it's not possible to easily calculate that either. That's partly because Freedom Finance didn't take full details of the unsecured loans. But it's mainly because the secured loan has 15 years left to run, and will shortly move to a variable interest rate. It's not possible to predict what might happen to interest rates in the future, and using the future variable rate as it is now, or as it was in 2019 when the loan was taken out, risks leaving Mr K under- or over-compensated depending on future interest rate movements.

I also bear in mind that one of the reasons this loan was unsuitable was because it secured previously unsecured debts to Mr K's property – putting his home at risk if things went wrong. Since taking out this loan, things did in fact go wrong. Mr K no longer has his savings, he's lost his job, and he's entered into an individual voluntary arrangement (IVA).

As a secured debt, this loan sits outside the IVA. He's in arrears on the loan, and his property is at risk. Had Mr K retained the unsecured debts, his property would not be at risk and the debts (if they hadn't been paid off from his then savings or the sale of his car) would have been included in the IVA.

None of this could have been predicted at the time Mr K took advice from Freedom Finance. However, the consequences of securing unsecured debt are one factor the rules of mortgage regulation required Freedom Finance to take into account – because of a risk that a situation like this would arise. While Freedom Finance could not have predicted exactly what would happen to Mr K in the years since, the increased risks of securing debt were something it ought to have been aware of – and, in this case, those risks have come to pass.

The secured loan was taken out in around October 2019. At the time, the personal loan and car loan had less than five years to run. So if they had not been consolidated they would either have been paid off by now, or included in Mr K's IVA. Either way, he would no longer be subject to them.

Taking into account everything I've said, I think the fairest approach to putting things right in this case is for Freedom Finance to put Mr K in that position by repaying the current outstanding balance of his secured loan to the lender.

I recognise this isn't ideal. Mr K has benefitted from the consolidation by reduced monthly payments, at least for the period he was making them. So there's a risk this approach over-compensates him. In recognition of that, I don't intend to award further compensation for distress and inconvenience. And the alternatives, as I've set out above, also carry risks that Mr K will be over-compensated or under-compensated. I don't think there is any way of awarding redress that exactly compensates Mr K for his losses, which are essentially unquantifiable, or that exactly replicates what, properly advised, he would have done instead.

My remit requires me to award what I consider to be fair compensation. Where it's not possible to exactly calculate a loss, that includes doing the best I can in the circumstances. I'm satisfied my proposed redress is fair in all the circumstances of this case."

Mr K accepted my provisional decision. But Freedom Finance didn't. It said:

- There were no indicators that Mr K was vulnerable during its contact with him. I've said he didn't lack capacity at the time. So it's not appropriate for me to take his circumstances at the time into account.

- Mr K's financial situation since he took the loan out – in particular the IVA – is not something Freedom Finance could have predicted. It made him aware of the risks of securing debt over his property, and had no control over Mr K's actions after taking out the loan. The secured loan reduced his payments and therefore provided a solution to his situation at the time. He benefitted from a reduction in his outgoings for four years.

- If the debts had not been secured, Mr K would have had more equity in his property and so an IVA might not have been an option at all.

- Mr K could not have sold his car as it was subject to a hire purchase agreement, so the finance would need to be cleared before the car could be sold.

- Freedom Finance was aware Mr K had savings, but he intended to use them for home improvements – which he wouldn't have been able to do had he used the funds to repay his debts.

- I have suggested that secured finance can never be suitable. Freedom Finance does not agree and says it is for the customer to consider the risks.

- Freedom Finance did not reassure Mr K that he wouldn't keep the loan for the full term, it merely presented him with his options.

- This was a suitable recommendation which was appropriate for Mr K's needs and circumstances. Mr K is responsible for his subsequent financial difficulties, and it is unfair to require Freedom Finance to pay for that.

- Even if I were to uphold the complaint, my proposed redress would not be appropriate and over-compensates Mr K. Mr K borrowed £22,500 and has paid approximately £13,500 – had he made the same repayments to the unconsolidated debt, he would still have a balance of around £9,000 left. That should be taken into account.

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.

That includes considering the further points Freedom Finance has made. But having done so I haven't changed my mind. I'll deal with the further points in the order they were made.

- I found that Freedom Finance couldn't reasonably have been aware of Mr K's circumstances at the time it gave advice. I haven't upheld the complaint on that basis. His circumstances are relevant as part of the factual background, but I haven't found that the loan was unsuitable on this basis.

- That Mr K would enter into an IVA at the specific time he did wouldn't have been something Freedom Finance could predict at the time of the advice. But while that specific outcome might not have been predicted, the consequences of securing previously unsecured debt more generally are predictable. The rules of mortgage regulation specifically require advisers to take into account the appropriateness of securing unsecured debt when giving advice. It's not enough to say that Mr K was made aware of the risks in general terms; Freedom Finance ought to have considered whether doing so was appropriate for Mr K in his specific situation before making a recommendation. It didn't do that.

  Had it done so, for the reasons I gave in my provisional decision, it ought fairly to have concluded that securing Mr K's debt, in his circumstances as they were at the time of the advice and as Freedom Finance knew or ought to have discovered them to be, wasn't appropriate or necessary. He had substantial savings and had other means of addressing the unsecured debts rather than securing them over his property.

  While it couldn't have been foreseeable that Mr K would incur further debt and end up in an IVA when he did, it is a foreseeable risk that secured debt – unlike unsecured debt – is excluded from most debt management strategies. Securing debt unnecessarily therefore foreseeably creates a risk that should things go wrong in the future the borrower's options for dealing with the debt are more limited and they risk losing their property.

  It's not enough to say that Freedom Finance informed Mr K of the risks of securing his debts to his property. As the regulated adviser, it should have considered whether it was appropriate for Mr K to take that risk. In this case, it didn't do so, with the result that when he later experienced financial difficulties these debts were still outstanding and could not be included in Mr K's IVA.

  As to whether Mr K might or might not have been able to take an IVA had he not consolidated these debts, that can't be known. It's equally possible that had he not consolidated them they might have been largely or entirely paid off by the time he entered an IVA. The point here is not what specific options Mr K might have had four years later, it is that by recommending that he consolidate previously unsecured debt into a secured loan, Freedom Finance exposed Mr K to additional risk without considering whether that was suitable.

- A hire purchase agreement can be terminated at any time. There's a cost to doing that, depending on how long the agreement has been outstanding. But it might still have been more advisable for Mr K to consider terminating the agreement and coming to an arrangement with the provider for the repayment of any outstanding sums – or using his savings to repay the agreement – rather than securing the debt over his property over a 20 year term. The rules of mortgage regulation require an adviser to consider whether it is appropriate to secure a previously unsecured loan. While I wouldn't expect Freedom Finance to give Mr K detailed advice on managing his unsecured debt, I would expect it to consider whether it was more appropriate to secure it over his property than the alternatives.

- Freedom Finance didn't enquire into the extent of Mr K's savings or discuss his plans for them. And it didn't consider whether it was suitable for Mr K to consolidate unsecured debt when he had considerably more than those debts in savings.

- I’m not persuaded that Freedom Finance was merely presenting Mr K with a range of options. I think Mr K was concerned about the total amount he would have to repay over a much longer term than his existing debts, and was persuaded that he didn’t need to worry about that because he wouldn’t keep the loan for the full term. This was presented as a definite strategy. I don’t think it was appropriate – this was at best speculative, but was used to persuade Mr K he didn’t need to worry about the overall cost of this borrowing.

- I have not found that secured borrowing can never be appropriate, even in cases of debt consolidation. My findings are limited to whether Freedom Finance made a suitable recommendation and acted fairly and reasonably in the specific circumstances of this individual case.

- I agree that Freedom Finance is not responsible for Mr K’s future financial difficulties. It is responsible for recommending this loan and no more. But it is foreseeable, and something that should be taken into account, that securing previously unsecured debt carries a range of extra risks – one of which came to pass in this case. I’m not persuaded that Mr K had a need to take out this loan and consolidate his unsecured debt, and I consider that Freedom Finance is responsible for the consequences which followed from its unsuitable recommendation.

- I explained in my provisional decision my reasons for proposing the redress I did. I don’t think there is a straightforward way of putting matters right in this case. I’ve considered what Freedom Finance says. But I don’t think the amount Mr K has paid to the secured loan is the right measure of what position he would have been in but for this recommendation. The terms of the consolidated loans were much shorter, and would have come to an end by now. I think it’s more likely than not that had the debts not been consolidated Mr K would either have paid them off – or, when his later financial difficulties arose, he would have included them in his IVA. Either way, he would no longer be subject to those debts and so putting him in that position is, in my view, the fairest way to resolve this complaint. In recognition of the risk that this may involve an element of over-compensation, I don’t intend to make a separate award for distress and inconvenience. As I said in my provisional decision, there is no straightforward way of putting things right, and I think this is the fairest of the available options in the particular circumstances of this individual case.

For all those reasons, and the reasons I gave in my provisional decision, I uphold this complaint.

My final decision

My final decision is that I uphold this complaint and direct Freedom Finance Limited to clear the outstanding balance of Mr K’s secured loan.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr K to accept or reject my decision before 10 January 2024.

Simon Pugh
Ombudsman