

The complaint

Miss C and Mr T complain that Equifinance Limited irresponsibly lent them a second charge mortgage (secured loan) which was unaffordable for them.

What happened

Miss C and Mr T took out a secured loan with Equifinance in 2017. They borrowed £20,000 plus around £3,400 in fees. The loan was on a repayment basis over ten years at a variable interest rate, initially 18%.

Miss C and Mr T say they were in financial difficulties at the time. They were in arrears on their main mortgage, as well as on other secured lending and with utility companies. Miss C was regularly gambling beyond their means. They applied for this loan and managed to keep up with the payments at first, but then fell into arrears. They don't think they have been treated fairly and despite now paying more than the monthly payments, are not reducing the amount owed. They still owe more than they borrowed with less than four years of the term left.

As part of considering their complaint, our investigator obtained Miss C and Mr T's bank statements from the time of the application. She said that Equifinance ought to have obtained them at the time. She said that the statements showed that their outgoings were higher than had been declared at the time, and that they showed substantial regular payments to gambling firms that hadn't been taken into account by Equifinance. She said that this evidence showed that the loan wasn't affordable or sustainable and shouldn't have been lent.

Equifinance agreed that if it had seen the bank statements at the time, and knew what they said, it wouldn't have lent. But it said it didn't in fact have them. There was no obligation for it to request them, or for it to obtain any other evidence of outgoings. It assessed affordability in line with the regulatory obligations applicable at the time and reasonably concluded the loan was affordable based on what it knew or ought to have known at the time of the application.

As no agreement could be reached, the complaint comes to me for a final decision to be made.

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.

It's not in dispute that if Equifinance knew in 2017 what it knows now, it wouldn't have lent. So the main question I have to decide is whether Equifinance ought reasonably to have known the true position with regard to Miss C and Mr T's finances and outgoings, including the gambling spending.

At the time of the lending decision, secured loan applications like this one were (and still are)

covered by the rules of mortgage regulation, found in the MCOB section of the Financial Conduct Authority's Handbook.

The rules require a lender to assess affordability, and not lend unless a loan is affordable. In making the assessment, a lender must obtain evidence of income, and information about expenditure. It can assess expenditure based either on a borrower's actual declared expenses, or it can use modelled expenditure information – such as typical expenditure figures for a household of this type – for living expenses, but must always use actual figures for committed expenditure such as other credit agreements.

The rules also say that a lender is entitled to rely on what it's told about expenditure – “unless, taking a common sense view, it has reason to doubt” it.

Miss C and Mr T's credit report showed they'd taken a series of payday loans in 2014. There were at least 15 defaults registered on their credit files dating between 2013 and 2016, many of which were still outstanding, as well as arrears on other accounts.

The application form showed that Miss C and Mr T earned around £2,750 per month after tax between them. Their expenditure (including this loan) was £2,069. They wanted to consolidate 11 unsecured debts, totalling around £12,700.

I've seen an email the broker sent to Miss C, asking for “an explanation as to why expenditure for food, utilities, clothing, transport and health costs are quite low”. Miss C replied to say that she had been on maternity leave, and then re-trained and spent three years studying with no income. As a result “our outgoings as a family are low due to economising as we have got used to it in the past and we are not going to start wasting money just because we are earning more”.

Equifinance says it was sent that email by the broker and took it into account. It says it benchmarked Miss C and Mr T's declared expenditure against typical household expenditure, and says what they had declared was plausible – especially taking into account the past financial difficulties caused by Miss C's period out of work. It says that this loan cleared their unsecured debt and also their arrears with their first charge mortgage lender, and reduced their overall outgoings by £172 per month. It wasn't required to ask for bank statements or other evidence of expenditure and, based on what it was told at the time, saw no need to.

I've taken into account what Equifinance said, and the information it received at the time, as well as what the rules of mortgage regulation say.

I do think that Equifinance ought to have made further enquiries into Miss C and Mr T's expenditure at the time. Although the minimum standard required by the rules is only to obtain information about expenditure, there is an overarching obligation to act fairly and as a responsible lender.

Despite both Miss C and Mr T now working, there were minimal expenses for childcare declared on their application form – even though the email to the broker had said they couldn't rely on family for childcare.

It's clear from Miss C and Mr T's application and wider circumstances that they were in significant financial difficulty at the time of their application. They were in substantial arrears on their main mortgage, and their mortgage lender would only agree to a second charge if the arrears were cleared with this loan. They had many relatively recent defaults on their credit file, as well as current arrears on credit cards and with utility suppliers. Many of the defaults were payday loans and mail order agreements. So I don't agree with Equifinance

that their credit file showed that their problems were in the past and they were bringing things back under control.

Miss C and Mr T gave an explanation of their past financial difficulty related to Miss C's period out of work studying. But whatever the explanation, I think it's clear from the information presented to Equifinance that their lifestyle had been unsustainable on their income and they had been running up debts, including recently before this loan was taken out. In those circumstances, I think – acting responsibly – Equifinance ought to have satisfied itself that this was no longer the case by making more detailed enquiries into Miss C and Mr T's expenditure rather than taking what it was told at face value.

I think there were grounds for doubting some of the individual expenditure Miss C and Mr T declared. And, more broadly, there were grounds for doubting whether Miss C and Mr T were really living within their income – or whether, as their credit history suggested – living beyond it.

I'm therefore satisfied that, acting responsibly, Equifinance ought to have made those further enquiries. Had it done so, it would have discovered the matters it now agrees would have led it to decline to lend had it known them at the time. In my view, Equifinance ought reasonably to have discovered them at the time, and it follows that it didn't lend responsibly. I therefore uphold this complaint.

Putting things right

To put matters right, Equifinance should remove all interest and fees added to the loan, leaving only the capital that Miss C and Mr T borrowed. I don't think it would be fair to write off the capital too, since Miss C and Mr T had the benefit of that. But I don't think it would be fair for Equifinance to collect interest on a loan it shouldn't have lent.

Equifinance should therefore treat all payments Miss C and Mr T have made as payments to reduce the capital. If, having done so, they would have cleared the capital balance by now then Equifinance should refund the excess to them, adding simple annual interest of 8% running from the date payment was made to the date of refund. If this is the case it may deduct income tax from the 8% interest element, as required by HMRC. But it should tell Miss C and Mr T what it's deducted so they can reclaim the tax if they're entitled to do so.

If, on the other hand, there remains a balance outstanding then Equifinance should come to an affordable arrangement with Miss C and Mr T to repay the balance. It can retain the standard security over their property until the remaining capital balance is repaid.

Finally, Equifinance should remove all adverse entries regarding this loan from Miss C and Mr T's credit files.

My final decision

My final decision is that I uphold this complaint and direct Equifinance 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 Miss C and Mr T to accept or reject my decision before 15 April 2024.

Simon Pugh
Ombudsman