DRN-4440496

The complaint

Mr R complains that Evolution Lending Limited irresponsibly lent him two second charge mortgages (secured loans).

What happened

Following advice from a broker, Mr R took out a second charge loan with Evolution in June 2018. He borrowed around £10,500 at an interest rate of 19.56% with a term of five years. The loan was for debt consolidation and home improvements. Mr R kept this loan for around five months before paying it off in November 2018.

In July 2020, following advice from a different broker, Mr R took out a new loan with Evolution. This time he borrowed just over £17,000 at an interest rate of 23.14% and a term of ten years. Again, the loan was for debt consolidation and home improvements, and again Mr R paid it off early, this time in March 2021.

In 2023 Mr R complained to Evolution that it had lent both loans to him irresponsibly and that the lending was unaffordable for him.

Evolution said it had carefully assessed Mr R's income and expenditure on both occasions and the lending was affordable. It said Mr R had made all repayments in full and on time.

Our investigator didn't think Evolution had lent responsibly. Evolution didn't agree with his assessment, so the case comes to me for a 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.

On both occasions, Evolution Lending didn't give Mr R advice or assess whether the loans were suitable for him – other firms did that. So Evolution wasn't responsible for that advice and wasn't required to assess itself whether the loans were suitable. But it was required to lend responsibly, including by making sure that the loans were affordable.

In carrying out an affordability assessment, Evolution should obtain evidence of income and information about expenditure. It can rely on what it's told, unless there are common sense grounds for doubting it. Evolution should consider whether a loan is affordable over its whole term, including if interest rates were to increase. It should also think more widely about whether it's responsible to lend and whether the borrower will be able to repay it sustainably.

In respect of both loans, I think there was sufficient information in Evolution's possession that ought to have led it to question whether the lending really was affordable and sustainable for Mr R. And if it had thought about those issues, I don't think – acting fairly – it ought to have lent.

In respect of the first loan, there were several matters of concern – highlighted by our investigator – about the income and expenditure information obtained by Evolution. In respect of income, it obtained payslips but didn’t take into account deductions from Mr R’s salary for advance payments he’d received. These deductions were a substantial part of Mr R’s salary for two of the three months of payslips, but Evolution didn’t question this or take it into account.

Evolution says that it didn’t consider Mr R’s credit file at the time. I find this surprising, especially as it had his credit file in his possession. This isn’t, as Evolution said to our investigator, a matter of giving advice – it’s a matter of understanding Mr R’s committed expenditure (relevant to affordability) and his approach to credit (relevant to sustainability).

Mr R’s credit file showed that he had taken out a large number of unsecured loans in the months leading up to this application. His credit card was at its limit and his bank statements show he was using his overdraft. Only a small proportion of this debt was consolidated by Evolution’s loan. Mr R was guarantor on another loan which Evolution didn’t take into account.

Evolution also had Mr R’s bank statements. The bank statements show substantial spending on gambling – many transactions to several companies. Evolution asked about this and Mr R said that payments to one gambling company were made by his brother. Evolution didn’t question this, and didn’t ask about payments to the other companies.

The bank statements also show regular large cash withdrawals on top of Mr R’s day to day expenditure through direct debits and debit card payments. Evolution suggested that the payments might be for paying for utilities in cash – but it didn’t ask that at the time, has no evidence to support that, and in any case that doesn’t explain the size of the withdrawals. I think the fact that, in some months, Mr R was withdrawing more than his income in cash ought to have led Evolution to question what the money was being spent on. The bank statements also show that Evolution underestimated Mr R’s expenditure. It got his council tax payment wrong.

Evolution carried out an interest rate stress test on Mr R’s first charge mortgage payments and this loan. It’s said it used an increase of 2.25% for the stress test. But the mortgage rules require a lender to take account of the Bank of England’s recommendation for stress tests, which at the time was 3%. So it’s not clear to me why Evolution used a lower figure.

Evolution’s initial expenditure assessment, even without considering the gambling payments or cash withdrawals, found that the loan was unaffordable. I’ve seen emails with the broker in which the broker explained to Mr R that Evolution would only agree to go ahead if Mr R consolidated more debt or reduced his expenditure – cancelling gym membership, breakdown cover and reducing his mobile phone bills were suggested. Mr R said he would pay off a credit card and cancel his gym membership – I’ve not seen evidence that Evolution followed this up to check whether he did.

I think the impact of all this was that Evolution might have over-estimated Mr R’s income, and did under-estimate his expenditure. The loan was only affordable if Mr R reduced other items of expenditure – but Evolution didn’t check he’d actually done so. It didn’t take into account that Mr R was making regular large payments to gambling companies and making large cash withdrawals – I think this pattern of spending, combined with the large amounts of unsecured credit Mr R had taken out in the months leading up to this loan, ought to have led Evolution to question whether the loan was sustainable for him. Taking all of that into account, I don’t think Evolution should, acting fairly and responsibly, have lent.

Mr R only kept this loan for a few months, then paid it off through other borrowing elsewhere. But less than two years later, he applied for another loan with Evolution.

This time, Evolution again obtained proof of income. It also obtained evidence of Mr R's expenditure and credit commitments.

At the time of the first loan in 2018, Mr R's first charge mortgage had a balance of around £10,000 with five years left. The mortgage and the Evolution loan added up to less than 50% of the value of his property. But by the time of the second loan, the first charge mortgage balance had increased to £48,000 and the term had been extended to ten years. Mr R's credit file showed that the earlier Evolution loan had been consolidated into an increased replacement second charge loan, itself consolidated into an increased first charge mortgage. The mortgage and second Evolution loan added up to 85% loan to value. I've seen no evidence that Evolution noted or took into account this increase in secured indebtedness over a short time in thinking about whether to lend, other than noting that the loan to value was within its lending criteria.

Mr R's unsecured indebtedness had also increased since the last loan. Around the same time he had increased his first charge mortgage, Mr R had also taken out a large unsecured loan and a large hire purchase agreement, as well as other loans. The credit card he had consolidated in 2018 was back up to its (now higher) credit limit.

Again, most of Mr R's unsecured debt was left unconsolidated by this loan, and most of the loan balance was paid direct to Mr R, with the stated purpose of funding home improvements.

This was the fourth increase in secured lending Mr R had taken out in two years – following on from the first Evolution loan, the secured loan that replaced it and the increased mortgage balance that replaced that. At the same time, Mr R's unsecured indebtedness was also increasing. I think this was a pattern of rapidly increasing debt which ought to have led Evolution to question whether further increasing Mr R's indebtedness – especially his secured indebtedness – was a sustainable thing to do.

Mr R managed to maintain the payments on this loan for a few months before he paid it off with yet more borrowing. Evolution says that the fact that he maintained all payments to both loans shows that they were affordable. But I don't think I can place much reliance on that. Both loans were only in existence for less than a year. And, looked at in the round, they're clearly part of a pattern whereby Mr R was borrowing more and more not just to pay off previous debts but also to take more money. The fact that he managed to continue doing this for the short period he had these loans doesn't mean that this was a sustainable long term strategy for him. And it doesn't mean that Evolution was justified in lending to him so that the cycle could continue.

In all the circumstances, I'm not persuaded that either loan was responsibly lent. I therefore uphold this complaint.

Putting things right

I don't think it's fair and reasonable that Evolution charged fees for setting up loans it should never have agreed to. And for the same reasons I think it should refund the interest it charged. However, I don't think it needs to refund any of the capital payments Mr R made. Most of the capital was paid to him directly and he had the use of it. And the relatively small amounts used to repay other debts also benefitted him.

I also think Evolution has contributed to Mr R's position overall worsening. It facilitated his spiral of indebtedness, borrowing ever larger sums secured to his property. Mr R has explained that it became ever harder for him to sustain these debts. And while he has to take some responsibility for that, Evolution should not have lent to him and doing so caused distress and made his situation worse. I agree with our investigator that £250 compensation is fair. As Mr R didn't miss any payments, there should be no adverse entries on his credit file for Evolution to remove.

My final decision

My final decision is that I uphold this complaint and direct Evolution Lending Limited to:

- Recalculate the settlement balance of the first loan to remove all fees and all interest charged.

- Pay Mr R the difference between the revised settlement figure and the amount Mr R actually paid to redeem, adding simple annual interest of 8%* running from the redemption date to date of refund.

- Carry out the same exercise for the second loan, again adding simple annual interest of 8%* running from the redemption date of this loan to date of refund.

- Pay Mr R £250 compensation.

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

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr R to accept or reject my decision before 26 March 2024.

Simon Pugh
Ombudsman