DRN-4644499

The complaint

Mr F and Miss H complain they were mis-sold a second charge mortgage (secured loan) by Freedom Finance Limited.

What happened

In February 2019 Mr F and Miss H took advice from Freedom Finance, which recommended they take a secured loan with a lender I'll call U. They borrowed around £21,500, including over £2,400 in fees, over a ten year term – although the loan was in joint names, it was secured over a property solely owned by Miss H. The interest rate was fixed at 6.15% for five years, followed by a tracker rate of 5.05% above the Bank of England base rate thereafter.

The purpose of the loan was to consolidate unsecured debt. Both Mr F and Miss H had several credit cards with substantial balances, car loans and other unsecured lending. Miss H also had a first charge mortgage over the property.

Mr F and Miss H are represented in this complaint by a friend I'll call Mr R. Mr R says that at the time of the loan Mr F and Miss H had been in a relationship for under two years. Mr F had moved into Miss H's property. Prior to the relationship, Miss H had not had substantial debts (other than the mortgage). But since then her indebtedness had substantially increased because Mr F did not contribute to household expenditure, spent heavily himself and also spent on Miss H's credit cards as an additional cardholder. Mr R says that the level of debt was getting out of control, so Miss H applied for this loan to simplify and reduce expenditure and "buy some time".

This loan was used to pay off five credit cards in Miss H's name and a personal loan in Mr F's name. But it did not clear all their unsecured debt and Mr R says this loan, together with the remaining debt, proved unaffordable. Ultimately Mr F is contemplating entering bankruptcy and Miss H is seeking arrangements with her creditors – Mr R says that without this loan they could have taken action to deal with their unsecured debts much sooner.

Mr R therefore complained to the lender, which responded itself in respect of the lending decision, and forwarded his complaint to Freedom Finance to address whether the loan was suitable. In respect of Freedom Finance's role, Mr R says that the loan was mis-sold for a number of reasons. In summary he says:

- The loan application significantly understated Mr F and Miss H's expenditure. While it's true Miss H gave unrealistically low figures to Freedom Finance, this was because she was desperate. Freedom Finance ought to have realised that what it was told was unrealistic, challenged it, and discovered the true situation. It ought to have seen that Miss H in particular had substantially increased her credit commitments in recent months and questioned whether the loan was sustainable.

- The loan may have reduced their monthly expenditure by around £350 – but that does not make it affordable. And it has not reduced their overall debt burden, since large fees were added, the borrowing was over an extended term, and the loan is secured over Miss H's property, putting her home at risk. Even after the loan, Mr F and Miss H continued to use credit cards to fund daily expenditure so their unsecured debts continued to increase.

- When she applied for the loan, Miss H intended only to consolidate her debts. But it was necessary to include Mr F's income to make the loan affordable and Miss H was pressured into including some of Mr F's debt rather than more of hers to avoid the need for Mr F to take independent legal advice at extra cost. An interest free loan of Mr F's was included in place of high-interest credit card debt in Miss H's name.

- Freedom Finance did not ask for evidence such as bank statements to verify what it was told.

- Freedom Finance sold the loan on the basis that Miss H could repay it in one or two years by further borrowing on her main mortgage. This was not plausible and designed to distract attention from the overall cost of the loan.

- Freedom Finance misled them or made inappropriate comments during the sales process. It was not giving advice at all; it was determined to sell them a loan at all costs, even to the extent of offering to send someone to their property at 10.00pm to get the loan paperwork signed quickly.

- There was no arrangement in place between Mr F and Miss H in respect of their finances or to repay this loan. Mr F is now considering being made bankrupt. This would leave Miss H solely responsible for repayment.

- Freedom Finance ought to have recognised that the loan was unaffordable and unsuitable for Mr F and Miss H and advised them not to proceed. Had they taken debt advice instead, their situation would now be very different. Miss H would not have a loan secured over her property and would not have delayed taking debt advice in the hope this loan would solve their problems; Mr F would not be liable for a loan, 90% of which was used to repay Miss H's debts.

Freedom Finance didn't agree the loan had been mis-sold. It said it had given proper advice and made a suitable recommendation which had achieved what Mr F and Miss H wanted, and reduced their outgoings. Our investigator didn't think the complaint should be upheld, but when it came to me for a decision I didn't agree.

My provisional decision

I issued a provisional decision to give the parties a chance to comment on my thoughts on the complaint before I make a final decision. I said:.

> "In order to decide whether Freedom Finance gave suitable advice and made a suitable recommendation, it's first necessary to understand what it was required to do and what it actually did.
>
> The obligations on a mortgage adviser giving advice are set out in the rules of mortgage regulation, known as MCOB, and found in the Financial Conduct Authority's Handbook.
>
> The rules say that an adviser must take reasonable steps to make sure that any mortgage recommended is suitable for its customers – in this case Mr F and Miss H. In doing so, it should obtain all relevant information, and may rely on what it's told unless there are common sense grounds for doubting it.

A mortgage is only suitable if it's appropriate to the needs and circumstances of the borrowers. If there is no suitable mortgage available, no recommendation should be made.

Where, as here, the loan is intended to consolidate existing debt, an adviser should also take account, when assessing whether the mortgage is suitable, of any increased costs associated with consolidation; whether it is appropriate to consolidate previously unsecured debt; and, where the customer is known to have payment difficulties, whether it would be more appropriate to come to an arrangement with creditors rather than take out a secured loan.

Finally, as with all regulated firms, Freedom Finance is required to take account of its customers' best interests and treat them fairly.

The debts consolidated were credit / store cards in Miss H's name, with a total balance of £17,139, and a personal loan in Mr F's name with a balance of £1,997.

Freedom Finance said it didn't send Mr F and Miss H a written record of its advice; it said there's no obligation to do so. It said its advice was given on the calls it had with them. With that in mind, I've listened to the calls between Mr F and Miss H and Freedom Finance. There were later calls to deal with administrative matters, but the substantive information gathering and advice was done in two calls on 5 February 2019.

- The first call – Freedom Finance called Miss H because she had completed an online application but not taken a loan out. So Freedom Finance called to see whether the loan could go ahead. Miss H said she wanted to borrow to consolidate credit card debt. She was looking for £15,000 over a four or five year term. Freedom Finance took details of her income. She said Mr F was contributing to the household too. Freedom Finance then carried out a search of its lending panel. It didn't say whether or not it had found a loan for Miss H. But it said she might qualify for more loans at better rates if she applied in joint names because having a higher income would improve the interest rates offered. It asked if Miss H's partner would be happy joining the application; she said he would and gave his details. Freedom Finance then said there were lenders available, and Miss H would need to speak to a mortgage adviser.

- The second call was with a mortgage adviser. Miss H said the debts to be consolidated were credit cards. She said that they were joint debts, but only in her name, as he had used her credit cards. Freedom Finance took details of expenditure. Miss H said that joint expenditure on food was £100 per month, with no expenditure on clothing, or on socialising or entertainment "because we both work too much". Freedom Finance questioned the clothing figure but not other figures, and Miss H amended that to £100 per year. They then went through all the debts recorded on Mr F and Miss H's credit files. There was a discussion about which debts to include in the consolidation – Miss H was unwilling to borrow much more than £15,000 because she was concerned about the level of the repayments. The adviser said that if the loan was in joint names but only Miss H's debt was being repaid, the lender would require Mr F to take independent legal advice as he would be taking out a loan he wouldn't be benefitting from, which would cost them extra. The other option would be to include some of his debt as well. Miss H said she would decide that later. Miss H said that her main mortgage company had refused to lend her extra to consolidate her debt, but her hope was that if she could clear some debt with this loan she would be able to re-apply and pay off this loan in a year or two. Miss H suggested that she and Mr F could take out separate loans for half the amount each. But the adviser said that she wouldn't get an unsecured loan and Mr F needed to be on the secured loan.

There was a discussion about the interest rate, loan term and overall cost. The adviser said that it would take longer than the loan term to repay the credit cards at the minimum payments Miss H was paying. And the lender would allow overpayments during the loan term. Miss H would reduce her monthly outgoings which would be a substantial saving and might be able to re-mortgage soon. The adviser said it was a "no-brainer" – the only thing to decide was whether or not to include some of Mr F's debt.

Towards the end of the discussion, the adviser said that there were also £2,300 in fees to be added to the loan balance they had been discussing, but that would be rolled up into the loan. Miss H agreed she couldn't afford to pay the fees up front. The adviser said the fee would pay for itself within six months because of the reduction in outgoings it would enable.

The adviser said an agent would need to visit Mr F and Miss H to get them to sign forms to allow the loan to go ahead. An appointment was booked for the following evening.

Both these calls were with Miss H only. I've not seen any evidence of any contact between Freedom Finance and Mr F, other than the signing of the application form. It therefore seems that no advice was given to Mr F at all. There was no discussion with him about his own needs and circumstances. There was no consideration of whether it was appropriate for him to take out a further loan, 90% of which was to repay debts in Miss H's name and which was secured over her property. Freedom Finance only gave advice to Miss H, and only considered her needs and circumstances.

Mr F was exchanging sole liability for an unsecured loan of £2,000 and monthly payments of £60 with joint and several liability for a secured loan of £21,500 and monthly payments of £240. It's clear from the call with Miss H that the only reason for including Mr F on the loan at all was that it wouldn't be affordable for Miss H to borrow the amount she needed on her own. There was no consideration of whether this was suitable for Mr F or in his best interests.

All the contact was between Freedom Finance and Miss H. But, having listened to the calls, I'm not persuaded that Freedom Finance gave any, or at least any proper, advice to her either. The aim of both calls was to understand what Miss H wanted and then to sell her a loan that gave her that – but giving suitable advice is not merely a question of giving a customer what they want, it's a question of establishing what is appropriate for their needs and circumstances. This includes not selling a loan if there is no suitable one available.

In the conversations with Freedom Finance there was no real discussion of the consequences of securing previously unsecured debt. There was some discussion of the relative costs of the secured loan compared to the credit cards it replaced – and I agree it's likely that the loan would have been cheaper overall than continuing to make minimum payments on the credit cards. But it's clear Miss H was struggling to manage her unsecured commitments, and there was no consideration of whether it would have been more appropriate for her to come to an arrangement with the lenders, or take debt advice, rather than taking out a secured loan that would only repay some of her existing debt, and secure the part consolidated to her property. Freedom Finance is not required to give debt advice. But it is required to consider whether it would have been more appropriate for Miss H to consider that rather than taking out this loan.

Most of the debt being consolidated was credit cards, not loans. Once they were paid off with this loan, the credit card balances would be available again. But Freedom Finance didn't discuss that with Miss H – it could, for example, have suggested that she close the accounts as well as pay off the balances, or warned her that if she ran up the balances again after taking out this loan her financial situation would worsen and cause difficulties in repaying this loan. But it didn't do that.

Between them, Mr F and Miss H had a large number of credit cards, three car finance agreements and several other hire purchase agreements, most of which had been taken out recently. I think Freedom Finance ought to have questioned whether they were living beyond their means, and whether they would continue to do so once this loan was taken out – including re-using the credit cards which would have their balances cleared.

Miss H said that she'd already applied to her main mortgage lender to consolidate the debts and been turned down. She said her plan was to apply again in a year or two to repay this loan. Freedom Finance accepted that and gave various reassurances about the long-term cost of this loan based on the likelihood of Miss H not retaining it for the full term. I'm not persuaded that this was realistic, and it ought to have warned Miss H that there was no guarantee her main mortgage lender would agree further borrowing in the future, and not to base her plans on that expectation.

Taking this loan wouldn't reduce Miss H's overall indebtedness, and – unless she closed the credit card accounts – would increase her total available credit. It's far from certain that her main mortgage lender would consider this resolved its concerns about her credit history, and Freedom Finance should not have assumed that it would. It was appropriate for Freedom Finance to source a loan that would allow Miss R to repay without penalty, but not appropriate to proceed on the basis that she would be able to.

Mr R says that Freedom Finance ought to have questioned the expenditure information Miss H gave. And I agree that the figures for food, utilities, and clothing in particular seemed low. This didn't ultimately result in the loan being lent on the basis of underestimated expenditure, since the lender used typical household expenditure rather than the actual figures Miss H gave Freedom Finance. But while affordability is primarily a matter for the lender, it's also relevant in my view to whether the loan is suitable.

The purpose of this loan was to reduce Mr F and Miss H's expenditure on their credit commitments to manageable levels – but given the debt would become secured over Miss H's property it's not enough that it reduces their outgoings; it would only be suitable if it reduced them to a manageable and sustainable level. Given that several finance agreements had been taken out recently, and the credit card balances were also going up, I think it would have been reasonable to question what Mr F and Miss H were spending these sums on if their declared expenditure was so low – that's relevant to whether they would be able to sustain this loan in the future, or whether their debts would continue to spiral after consolidation. And as such it's an important consideration in whether the loan was suitable.

Overall, I'm not persuaded Freedom Finance made a suitable recommendation to Mr

F and Miss H. During the course of the sales call the balance increased from the £15,000 that Miss H initially wanted to over £21,000 including fees. Miss H initially wanted a loan in her sole name to clear her debts. Mr F was only added because that wasn't affordable for her, but there was no discussion with him (either separately or jointly with Miss H) about whether that was in his best interests or whether the loan was suitable for him. No consideration was given to whether this was a more appropriate course of action than Miss H dealing with her unsecured debt in some other way. Those things should have been explored and considered. And I think there was evidence that Freedom Finance ought to have explored and taken into account showing Mr F and Miss H were not managing their finances and that there was a risk that taking out a secured loan to free up credit card balances would make their situation worse not better.

<u>Putting things right</u>

Putting things right is not straightforward, however. If this recommendation had not been made, Mr F and Miss H would not have taken this loan and would have continued with their existing unsecured debt.

When he first brought the complaint, Mr R said that Mr F is applying for bankruptcy. There's no record on the register of bankruptcies that he's done so yet. But if he does, he will no longer be liable for this loan – since secured loans are included in personal bankruptcy; while the lender can still call in its security, Mr F does not own the property the loan is secured over. Given what I've seen of his finances, I think it's likely Mr F would have ended up in much the same position even if he had not taken this loan.

However, even if Mr F does go bankrupt, that does not change Miss H's ongoing liability for the loan, or the fact that it's secured over her property. Mr R says that Miss H considered selling the property to repay this loan, but that was avoided through support from family. I don't think it would be fair to ask Freedom Finance to cover the costs of the abortive sale, since – as with Mr F's insolvency – it's likely Miss H would have needed to consider that anyway, either to avoid, or as part of, a formal insolvency procedure or arrangement with her creditors in the absence of this loan.

It's clear this loan didn't solve Mr F and Miss H's problems. But it didn't create them either. And, financially speaking, there were some benefits in the short term at least. It reduced their household outgoings substantially, buying them some breathing space to address their wider financial situation and remaining debt – though it seems they didn't do that, instead building their unsecured debt back up again. And the overall cost of repaying the debt is less now than it would have been had it remained on the credit cards and Miss H had continued paying the minimum payment.

But set against that, securing that debt makes it more difficult to deal with it in other ways, such as coming to an arrangement or some form of insolvency procedure. And it came at the cost of securing the debt against Miss H's property. It also allowed them to further increase their debts by making the credit card balances available again. There was good reason to conclude that even with this loan their situation wasn't sustainable. Ultimately it's those considerations that lead me to conclude the loan was unsuitable. The financial savings are outweighed by the risks the loan created. It wasn't an appropriate way to manage the debt problems Mr F and Miss H found themselves in.

I can't require Freedom Finance to remove the security, since that's a matter for the lender. But I can require it to compensate Mr F and Miss H. I don't think Freedom

Finance's advice caused them direct financial loss. The debts consolidated are, overall, cheaper than they would have been had they been left unconsolidated. But there were other consequences, including securing that debt to Miss H's property. And it's clear Mr F and Miss H were living beyond their means – this loan gave them the chance to do that for longer, and made it harder to address this part of their overall indebtedness when they found they could no longer sustain things.

I think it's fair and reasonable for Freedom Finance to compensate them for the distress and inconvenience that caused. I think £750 is a fair award in all the circumstances. Freedom Finance should also refund all the fees Mr F and Miss H paid to take this loan out – both the broker and lender fee – since, but for this advice, those fees would not have been added to their overall indebtedness. It should pay that amount to the lender to reduce the debt."

The responses to my provisional decision

Neither party agreed with my provisional decision.

While Mr R welcomed my intention to uphold the complaint, he didn't think the redress I had proposed went far enough. He said:

- He agreed that the adviser didn't give proper advice. He said that as well as discussing the consolidated debt and advising about future use of credit cards, the adviser ought to have identified that Mr F and Miss H were in a financial hole and "burying their heads in the sand". It should have been obvious they were living beyond their means and their spending was out of control, and this loan just made it easier for that to continue.

- The adviser wrongly gave Miss H the impression that she would have extra disposable income after the loan went through or that this loan would solve their financial problems and they could increase their spending on social activities.

- The reality is that Mr F and Miss H were in a cycle of debt and this loan made things worse, not better.

- As a result, all the interest should be refunded. Even though interest is charged by the lender, it was because of Freedom Finance that the loan existed at all. Neither party should benefit from a loan Mr F and Miss H should never have had. If Mr F and Miss H had sought debt advice instead, they might have ended up not having to pay interest at all – either because of an arrangement with their creditors, or because of family support instead of further borrowing.

- Instead, Miss H felt forced to sell her property to escape the loan. Mr R didn't agree that it was likely she would have had to consider doing that anyway had the loan never existed. He said that her debts had doubled since the loan was taken out, and part of them were now secured on the property. So she felt she had no choice. But properly advised she would have addressed her debt issues sooner and not reached that point.

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

- It's disturbing that I had reached a different conclusion to the investigator, which showed a lack of consistency. I had used hindsight and made unjustified assumptions.

- Mr F and Miss H's credit files show that Mr F had taken out two new items of credit in the six months before the advice, and Miss H had taken three. Freedom Finance doesn't think this is excessive, and neither party had evidence of payment problems with existing credit at the time of the advice. It didn't agree that Miss H was struggling to manage her existing commitments. There was no reason for Freedom Finance to doubt what she said.

- The secured loan not only reduced Mr F and Miss H's outgoings, it was also cheaper in terms of the overall amount and time needed to repay the debt that was consolidated. Miss H wanted to reduce her outgoings and deal with outstanding debts and the loan achieved that.

- Freedom Finance doesn't agree with my finding that any, or any proper, advice was given. It said it ensured Miss H and Mr F would be in a better position by taking the loan.

- Freedom Finance is not responsible for what Miss H and Mr F did after taking out the loan. It had no responsibility to advise them on how to manage their finances, such as by cancelling the credit cards consolidated.

- The loan gave Miss H and Mr F the chance to manage their finances and meet their objectives. If their debts increased since, that might have been because of other factors (such as the pandemic and cost of living challenges) and anyway couldn't have been foreseen at the time of the advice.

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 true that I reached a different outcome to the investigator. However, I don't agree that wasn't a course that was open to me, or shows that I've treated the complaint inconsistently. Our rules provide for an initial assessment, with the option for either party to have an ombudsman make a final decision if they disagree with the initial assessment. There would be no point in such a process if an ombudsman could never reach a different conclusion to an investigator. Nor do I think that there's evidence my provisional decision was internally inconsistent – summarising the arguments made by the parties does not mean I adopt them, and doesn't mean I am being inconsistent if I say something different to what the parties said in my findings.

I reached my provisional decision based on my own independent assessment of all the evidence and arguments – including those made in response to the investigator's view of the case – and I don't agree that I did so using the benefit of hindsight. I focussed on what was known, and what Freedom Finance ought to have known or anticipated, at the time of the sale of the loan.

I've considered the more substantive points Freedom Finance made disagreeing with my provisional decision. But having done so I haven't changed my mind. I remain of the view – having taken full account of the content of the calls with Miss H – that Mr F wasn't given any advice at all, and that the discussions with Miss H were more focussed on selling the loan that she wanted than considering whether it was appropriate for her.

I agree that there was no evidence of missed payments on Mr F and Miss H's credit files. But I don't think that's conclusive evidence that they weren't struggling with their finances. Their credit files do show substantial debts and a rapid escalation of their indebtedness, and high levels of credit utilisation. I think it's clear from the conversation with Miss H that doing something about their debts was necessary. And Freedom Finance's only response to that was to sell them a loan – without consideration of the other matters required by the rules.

I also think Freedom Finance was under an obligation, when thinking about whether the loan was suitable and whether this was the best way of dealing with their existing debt, to draw to Mr F and Miss H's attention the consequences of taking out further unsecured debt in the future – for example, by running up the cleared credit card balances. In my view this is very relevant to whether the loan is sustainable and whether it's a suitable method of resolving debt problems, as opposed to freeing up capacity to take more unsecured debt.

I agree Freedom Finance isn't responsible for the choices Miss H and Mr F made. But it is responsible for considering all the circumstances in deciding whether the loan it recommended was suitable for them. That includes assessing whether debt consolidation into a secured loan is the appropriate way of managing their existing debts – and includes whether the loan is likely to resolve their problems or perpetuate them.

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

Putting things right

I've also considered the points Mr R made about how to put matters right. I don't think it would be appropriate, in the circumstances of this case, to require Freedom Finance to refund the interest Miss H and Mr F have paid or will pay to the lender. Freedom Finance hasn't charged them that interest. And while I've found that the loan wasn't suitable for their wider circumstances, not least because it secured debt to Miss H's property and allowed them to take out further borrowing, the fact is that the debt that was consolidated was made cheaper than it would have been had it been left unconsolidated.

I've noted that Mr R believes that Miss H and Mr F wouldn't have had to pay that interest had they not taken this loan. But that would only be the case if they defaulted on those debts – which has other consequences – or if they received family support earlier than they in fact did. They might have received family support sooner, but they might not. I have no way of knowing for sure – but given it was only after Miss H had taken out a secured loan and after she had put her property on the market that she sought family help, I don't think it's more likely that not that she would have sought it as soon as Freedom Finance refused to arrange a loan.

For the same reasons, I'm not persuaded it would be fair and reasonable to require Freedom Finance to refund the costs of the abortive property sale. I think it's more likely than not that Miss H would have ended up in much the same place had Freedom Finance refused to recommend this loan – having to choose between insolvency and selling her property to repay her debts.

I'm therefore not persuaded to change the outcome I reached in my provisional decision. For the same reasons I gave above, I think the fair outcome is for Freedom Finance to refund the fees added to the loan balance and to compensate Miss H and Mr F for the distress and inconvenience its unsuitable recommendation caused.

My final decision

My final decision is that I uphold this complaint and direct Freedom Finance Limited to:

- Refund the £1,915 broker fee and £495 lender fee, together with compound interest at the mortgage rate running from the date the loan completed to the date the refund is paid. That amount should be paid to the lender to reduce the debt, together with any early repayment charge the lender charges on a partial repayment (I understand there is none, but I include this for completeness).

- Pay Mr F and Miss H £750 compensation. This sum should be paid to them direct unless they ask for it to be added to the payment to the lender.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr F and Miss H to accept or reject my decision before 8 April 2024.

Simon Pugh
Ombudsman