DRN-3123292

The complaint

Mr H complains about a guarantor loan provided to him by TFS Loans Limited, ("TFS"), which he says was unaffordable.

What happened

TFS provided Mr H with a loan of £12,000 on 2 December 2016. The loan was secured by a guarantor who would be responsible for repaying it if Mr H failed to make his repayments. The interest rate was 16.3% (29.9% APR). The loan was to be repaid by 60 monthly repayments of £362.70. If Mr H made each payment when it was due, he'd pay £21,762 in total. According to the most recent information I've seen, the loan hasn't yet been repaid. The loan was being used partly for debt consolidation to repay three payday loans and partly for home improvements.

Mr H said that he was in a cycle of payday loans and borrowing from family to pay for a gambling addiction. He had returned direct debit payments and wasn't in a position to borrow more money. No bank statements were requested from him. He'd made a few late payments on the loan and a payment was required from his guarantor.

In its final response letter, TFS concluded that it wasn't upholding Mr H's complaint. It provided details about the information provided to it by Mr H. The lender said that it had assessed the affordability of the loan using the information Mr H had provided to it and the information on his credit file. It had verified Mr H's income with an income verification system used by a credit reference agency. TFS said there was nothing on the credit checks to indicate any form of financial difficulty. Mr H was using the loan to repay his creditors and put himself into a much better financial position. TFS said Mr H's remaining monthly disposable income, after the new loan repayment, was £956.70 per month. If Mr H repaid the three payday loans, he would have had a remaining monthly amount of £2,291.70 to spend which deemed the loan affordable for Mr H. TFS also said that Mr H's gambling transactions were more than covered by his disposable income each month.

Our investigator assessed the complaint and recommended that it be upheld. He said that TFS didn't do enough to verify that Mr H could sustainably afford this loan. He thought it should've obtained evidence to provide a clear picture of his actual financial situation. As TFS didn't do that, he didn't think its checks were reasonable and proportionate. The investigator had reviewed Mr H's bank statements and said that if TFS had conducted reasonable and proportionate checks it would have found that the loan was not sustainably affordable for Mr H, despite this loan clearing some of his debts.

TFS disagreed with the investigator's view. It said that as Mr H was consolidating some of his debt, this would allow him to manage his monthly expenditure. He might have had an issue with managing his finances, but he didn't have an affordability issue. TFS referred to the investigator saying that some of Mr H's mortgage payments had been returned, but it said that this didn't mean that the payments weren't made. Its credit check showed one of the payments as made. TFS also said that all of Mr H's active credit showed as managed with no financial difficulties. It also said that Mr H had managed his loan account with it. In addition, TFS said that the loan application was approved based on the information provided by Mr H and a number of discussions took place to determine the details were accurate. TFS hadn't seen anything to suggest Mr H wouldn't be able to afford the loan and it was entitled to rely on what it had been told.

As this complaint hasn't been resolved informally, it has come to me, as an ombudsman, to review and resolve.

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.

When TFS lent to Mr H the regulator was the Financial Conduct Authority ("FCA") and relevant regulations and guidance included its Consumer Credit Sourcebook (CONC). Its rules and guidance obliged TFS to lend responsibly. As set out in CONC, this meant that TFS needed to take reasonable and proportionate steps to assess whether or not a borrower could afford to meet its loan repayments in a sustainable manner over the lifetime of the agreement.

Repaying debt in a sustainable manner meant being able to meet repayments out of normal income while meeting normal outgoings and not having to borrow further to meet these repayments.

The lender was required to carry out a borrower focussed assessment each time - sometimes referred to as an "affordability assessment" or "affordability check". Neither the law nor the FCA specified what level of detail was needed to carry out an appropriate assessment or how such an assessment was to be carried out in practice. The FCA said that the level of detail would depend on the type of product, the amount of credit being considered, the associated cost and risk to the borrower relative to the borrower's financial situation, amongst other factors.

The checks had to be "borrower" focussed. So, TFS had to think about whether Mr H could sustainably repay his loan. In practice this meant that the lender had to ensure that making the payments to the loan wouldn't cause Mr H undue difficulty or adverse consequences. In other words, it wasn't enough for TFS to simply think about the likelihood of it getting its money back, it had to consider the impact of loan repayments on Mr H. So even in this case where Mr H had a guarantor who had agreed to meet repayments if he couldn't, this didn't absolve TFS of its obligation to assess whether Mr H could meet his repayments without undue difficulty.

In general, I think that a reasonable and proportionate check ought generally to have been more thorough:

- the *lower* a consumer's income (reflecting that it could be more difficult to make any loan repayments to a given loan amount from a lower level of income);
- the *higher* the amount due to be repaid (reflecting that it could be more difficult to meet a higher repayment from a particular level of income);
- the longer the period of time a borrower will be indebted for (reflecting the fact that the total cost of credit is likely to be greater and the borrower is required to make repayments for an extended period).

Bearing all of this in mind, in coming to a decision on Mr H's case, I have considered the following questions:

- Did TFS complete reasonable and proportionate checks when assessing Mr H's loan application to satisfy itself that he would be able to repay the loan in a sustainable way? If not, what would reasonable and proportionate checks have shown?
- Did TFS make a fair lending decision?

Did TFS carry out reasonable and proportionate checks when it provided the loan?

As set out above, TFS gathered some information from Mr H about his income and expenses before it agreed the loan. I've listened to recordings of the calls between Mr H and TFS in which Mr H provided information about his expenses. TFS also carried out a credit check.

TFS's monthly income and expenditure details form showed Mr H's monthly income as £4,260 and his total regular monthly expenditure (including TFS's loan repayment of £362.70) was shown as £3,303.30 if Mr H didn't consolidate his debts. Mr H said that he wanted to use the loan for debt consolidation to repay three payday loans totalling around £5,700. He also said he was using TFS's loan for home improvements. TFS calculated Mr H's disposable income as £2,291.70 if he repaid the three debts and £956.70 if he didn't repay them. TFS said that Mr H's disposable income deemed the loan to be affordable.
I can see why TFS would think the loan repayments would be affordable based on what it had calculated. But I think it should have gathered more information than it did for the following reasons.

I'm concerned that TFS appears to have relied on Mr H's declared expenditure without verifying it. CONC 5.3.1(4) said:

If a firm takes income or expenditure into account in its creditworthiness assessment or its assessment required under CONC 5.2.2R (1):

1. *(a)*
   the firm should take account of actual current income or expenditure and reasonably expected future income or expenditure (to the extent it is proportionate to do so) where it is reasonably foreseeable that it will differ from actual current income or expenditure over the anticipated repayment period of the agreement;
2. *(b)*
   it is not generally sufficient for a firm to rely solely for its assessment of the customer's income and expenditure, on a statement of those matters made by the customer;

I think it would have been proportionate here for TFS to have verified Mr H's actual expenditure.

I've also reviewed TFS's credit report. TFS would have been aware from this that Mr H had a total credit balance of £224,641 outstanding which included a mortgage balance of nearly £213,000. The report showed that Mr H had four defaulted accounts from 2012 and 2013. Three of the defaulted accounts had been repaid. One account remained unpaid but was subject to a dispute. I don't think these defaults ought to have caused TFS additional concerns in view of their age. And I don't think it was unreasonable for TFS to be more interested in Mr H's more recent credit history for the purposes of assessing whether the loan was sustainable.
The credit report also showed that Mr H had a hire purchase agreement and a credit card balance which was £80 under the credit limit of £1,250.

More worryingly, the credit report shows that in the 12 months prior to taking out TFS's loan, Mr H had borrowed eleven loans which appeared to be short term loans, although they were not all described as such. He'd needed to borrow a short term loan every month except August 2016 (albeit he'd borrowed a loan on 30 July 2016) and November 2016. I think this information is at odds with the level of disposable income TFS said Mr H had each month. The most recent short term loan was taken out just two months before the loan application and had a relatively large balance of £1,817. Three of the loans in the five months prior to the loan application had been taken out very shortly after Mr H had repaid a previous one. This suggests that Mr H had needed to borrow in order to fill a hole in his finances that was made by making a loan repayment. This isn't a sustainable form of borrowing. The credit checks also showed that Mr H was taking out payday loans regularly throughout 2014 and 2015.

I think the regularity and extent of Mr H's short term borrowing ought to have caused TFS concerns about how Mr H was managing his money. I also think it might have been concerned as to why someone with such a large proportion of available income (according to TFS's assessment of Mr H's disposable income) would need to borrow so much expensive credit so regularly. And, I think TFS ought to have been concerned about Mr H's ability to repay its loan out of his usual means, without borrowing, as it didn't appear he was managing to do so with his existing debt.

TFS was also aware that its credit checks didn't show all of Mr H's credit commitments. Mr H had told it he wanted to repay two relatively large payday loans which didn't appear on its credit checks. And during a call between TFS and Mr H on 1 December 2016, TFS's agent told Mr H that payday loans didn't tend to come up on credit searches.

I can also see that Mr H was increasing his total indebtedness by taking TFS's loan. Whilst Mr H said that £5,700 from the £12,000 loan was being used to repay three payday loans, he needed £21,672 to repay TFS's loan. So, it appears that his total indebtedness was being significantly increased as well as the time he'd be indebted for.

Simply performing credit checks isn't enough. A lender needs to react appropriately to the information that any checks show. Mr H was entering into a relatively long and expensive loan agreement. He was entering into a commitment to make his monthly loan repayments for 60 months and was, after all, committing to repay £21,672 over that period.

So, I think it would have been reasonable and proportionate here for TFS to gather further information about Mr H's finances and to verify his actual monthly expenditure. It could have done this by, for example, requesting bank statements from Mr H, asking for copies of bills and/or receipts for his expenses and by asking him for more information about his existing credit commitments. As I can't see it did this, I don't think the checks TFS carried out before providing Mr H with his loan were reasonable and proportionate.

But that in itself doesn't mean that Mr H's complaint should succeed. I'd also need to be persuaded that what I consider to be proportionate checks would have shown TFS that Mr H couldn't sustainably afford the loan.

What would reasonable and proportionate checks have shown at the time? Did TFS make a fair lending decision when it provided Mr H with a loan?

Mr H has provided us with his bank statements from around the time he applied for this loan. I'm not suggesting here that these are the checks that TFS should have done. But I think looking at these gives me the best picture of what the lender should have seen. Had it sought some verification of Mr H's spending, I think TFS would've been in a better position to understand Mr H's financial situation before it decided to lend to him. I understand that TFS has now seen Mr H's bank statements which were supplied to it following his complaint. It will have seen that Mr H's income was around the amount Mr H had declared to TFS.

But TFS will also have seen from the statements that Mr H was having significant difficulties managing his finances. He had returned payments each month from September 2016 to December 2016. He'd told TFS that he had returned payments when he went on holiday and forgot to transfer money to cover his expenses. But there were also returned payments at other times. I also note that Mr H hadn't paid his mortgage in October 2016 and November 2016. TFS said that its credit check showed the mortgage as paid, but the credit check record had been updated on 13 November 2016 and may not have covered the October 2016 payment, and didn't cover the November 2016 payment. I also can't see on the bank statements I've seen that those mortgage payments were made from his current account.

I've also seen on the bank statements that Mr H appeared to be reliant on payday loans to supplement his income. From August to November 2016, he borrowed an average of £3,257.50 in payday loans each month. As Mr H was borrowing a significant amount from short term loan providers each month just to fund his existing expenditure and credit commitments, I think there was a very real prospect that Mr H would need to borrow again in order to repay his new loan and that would likely have a significant adverse effect on his financial situation.

So, if TFS had made further checks, I think it would have been clear to the lender that Mr H was spending beyond his means and had been for some time, and that further credit was likely to add to his indebtedness. I can see that Mr H continued to borrow from short term lenders shortly after taking out TFS's loan. Within 20 days he'd borrowed a payday loan for £2,225, and I think this was foreseeable.

TFS said that Mr H might have had an issue with managing his finances, but he didn't have an affordability issue. It seems to me that TFS was focussing on its calculation of whether the loan was affordable for Mr H on a pounds and pence basis. But the lender was required to establish whether Mr H could sustainably make his loan repayments – not just whether the loan payments were technically affordable on a strict pounds and pence calculation. The loan payments being affordable on this basis might be an indication that a borrower could sustainably make the repayments. But it doesn't automatically follow that this is the case. And as a borrower shouldn't have to borrow further in order to make their payments, it follows that a lender should realise, or it ought fairly and reasonably to realise, that a borrower won't be able to sustainably make their repayments if it is on notice that they are unlikely to be able to make their repayments without borrowing further.

TFS also said that Mr H was using the loan to repay his creditors and put himself into a much better financial position. It also said that as Mr H was consolidating some of his debt, this would allow him to manage his monthly expenditure. But, this assumed Mr H's need for credit wasn't an ongoing one and I think his reliance on expensive short term loans to meet his existing costs suggested that this wasn't a reasonable assumption.

I also note that Mr H had spent a relatively large amount on gambling transactions in October 2016 when his gambling transactions amounted to around £2,697. But I can't see any gambling transactions on the bank statements in August 2016. And in September 2016 and November 2016 the gambling spend was substantially less. TFS said that Mr H's gambling transactions were more than covered by his disposable income each month although I can see that wasn't the case in October 2016 where Mr H's gambling spend exceeded the disposable income calculated by TFS of £2,291.70 (if Mr H hadn't consolidated his debts with the loan).

I note that TFS said that Mr H had managed its loan. But Mr H said that he'd made some late payments and his guarantor had made a payment. So, it appears from what Mr H said, that he has had some payment problems with the loan and hadn't managed the loan as well as TFS had said.

Altogether, I think further checks on Mr H's circumstances wouldn't have provided any reassurance to TFS that he would have managed his repayments sustainably or that the loan was suitable for him. And I think TFS ought reasonably to have realised that it was unlikely that Mr H would've been able to sustainably repay his loan. So, it should reasonably have concluded that it treated Mr H unfairly when it agreed to lend to him. And so, I think it was irresponsible to have agreed to lend to him on this occasion. I think Mr H has lost out financially through paying interest and charges under this agreement and TFS needs to put this right for him as follows.

Putting things right – what TFS needs to do

I understand that Mr H's loan hasn't yet been repaid. I think it's fair that he repays the principal amount of £12,000 he borrowed as he's had the use of this money, but I don't think he should be liable for any interest or charges associated with the loan.

TFS should put things right for Mr H as follows.

- TFS needs to ensure that Mr H only repays the principal borrowed on the loan. In other words, he should not pay any interest or charges for this loan. So, TFS should remove all interest, fees and charges applied to the account from when it was opened.
- Treat any repayments made by Mr H as though they had been repayments of the principal on that loan.
- If this results in Mr H having made overpayments, then TFS should refund these overpayments with 8% simple interest* calculated on the overpayments, from the date the overpayments would have arisen, to the date the complaint is settled.
- If an outstanding principal balance remains then TFS should try to agree an affordable repayment plan with Mr H, bearing in mind its obligation to treat him positively and sympathetically in these discussions.
- Remove any adverse information recorded on Mr H's credit file as a result of the loan.

*HM Revenue & Customs requires TFS to take off tax from this interest. TFS must give Mr H a certificate showing how much tax it has taken off if he asks for one.

My final decision

My decision is that I uphold this complaint. In full and final settlement of this complaint, I order TFS Loans Limited to put things right as I've set out above under the heading "Putting things right – what TFS needs to do".

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr H to accept or reject my decision before 14 February 2022.
Roslyn Rawson
Ombudsman