

The complaint

Mr and Mrs H complain about their second charge secured loan with an unregulated lender. The loan is administered by Target Servicing Limited on the lender's behalf.

Mr and Mrs H complain that they've fallen behind with the loan payments and they won't be able to pay the outstanding balance. Mr and Mrs H say they've been charged exorbitant rates of interest and this has meant the loan balance has escalated. They also say they feel harassed by Target despite it knowing that Mr and Mrs H are suffering from chronic ill health.

Mr and Mrs H say they can't understand how the lender offered to reduce the balance outstanding by around £15,000 for final settlement but won't do the same if they don't clear the balance in full.

What happened

In January 2007 Mr and Mrs H took out an unregulated secured loan to consolidate other debts. They borrowed £42,750 (including fees) to be repaid over 25 years on repayment terms.

In July 2016 the ownership of the loan was transferred a new unregulated lender. That lender appointed Target to administer the loan on its behalf. In doing so, Target is carrying on the regulated activities of debt administration and debt collection. And so it falls to Target, as the regulated entity involved in the management of this debt, to answer this complaint.

Mr and Mrs H have struggled with the loan repayments and the loan was in arrears for many years, though it has been largely clear of arrears since 2017. They have faced periods of illness and other factors which have affected their finances. By the time they complained to us the loan balance had risen to around £50,000.

In 2020, Target offered Mr and Mrs H a reduced settlement figure if they were able to repay the loan off early – a reduction in the balance of £15,000. This offer was only valid for 30 days and Mr and Mrs H were not able to take it up.

Mr and Mrs H complained. They said it wasn't fair that Target and the lender were willing to reduce the balance if they could pay it all off at once – but if they couldn't, would expect them to pay it in full. They said that they'd already paid over £60,000, only to find themselves still owing more than they'd borrowed. At this rate, there was no prospect of them being able to pay the loan off at the end of the term.

Mr and Mrs H say they suffer from a range of physical health conditions but are doing what they can to make the payments. But they feel that there's no chance they'll ever be able to pay the loan off, and that Target and the lender are not interested in helping them. They say they accept that they borrowed the money and that they need to pay it back – and are willing to do so. But they don't think they're being treated fairly, because the loan balance and interest rate are such that they have little prospect of ever doing so. They don't understand why if the balance could be reduced by £15,000 if they could pay it off, it can't be reduced to help them when they can't.

Mr and Mrs H have complained about their loan before. In 2018, they complained that their loan balance was higher at that time than the amount they'd borrowed. Target said that was because the loan had been in arrears, and as a result the contractual monthly payment hadn't changed when the interest rate changed. To put this right, the previous lender had reduced the balance by £5,000 in 2012. But it did not change the monthly payment as the account was still in arrears – and the loan had been in and out of arrears ever since. The contractual monthly payment was currently set at a level below the interest charged each month. As a result, Mr and Mrs H had not been paying enough to reduce the balance – each month, they only paid off part of the interest and none of the capital. So the balance continued to rise. Target sent this final response in May 2018.

In December 2020, Target responded to a further complaint. Mr and Mrs H complained about a lack of information, including not having been sent loan statements. They complained again about the balance and that it hadn't reduced. And they complained about the sale of the loan, including that fees were added to the opening balance and that it was secured over their property. Target said it had sent annual statements, and would send Mr and Mrs H a full transaction history since the loan began. It referred back the explanation it had given in 2018 about the balance. And it referred their complaint about the sale of the loan to the broker which sold it.

That second complaint, responded to in December 2020, was the complaint referred to us and which I am deciding here.

I have already issued a decision setting out the position on our jurisdiction to consider this complaint. I said we couldn't consider the complaint about the sale of the loan. As the administrator since 2016 only, Target is not responsible for the sale. I also said that the matters covered in the May 2018 final response are now out of time. So I said that we could consider the fairness of how Target had treated Mr and Mrs H, including the loan balance and the amount they would need to pay – but only in respect of acts and omissions since 16 May 2018.

Our investigator then considered the merits of the complaint. In particular, he noted that Target had asked the lender to agree to freeze the interest (charge 0% from then on) from July 2021. This meant that from now on, every payment Mr and Mrs H make will go to reducing the loan balance – helping them get to a point where they will be able repay it. But he noted that the problem of too little payment being collected had been going on for some time. And he said freezing the interest should be backdated to July 2018, when Mr and Mrs H had discussed their payments with Target soon after their previous complaint. He said this was an opportunity to work with them to get the loan back on track Target should have taken.

Target did not agree, and asked for an ombudsman to review the complaint. It said it did not assume that a customer was in financial difficulty – it was for the customer to ask for assistance. It said that it had looked at Mr and Mrs H's income and expenditure and it thought the payments they were making were affordable for them. It said that they are contractually required to pay interest. And that Mr and Mrs H were aware for some time that the amount they were paying was not enough to cover the monthly interest, and had had opportunities to question this before – including in their complaint in 2018.

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.

I've explained that I've already issued a jurisdiction decision setting out what we can

consider as part of this complaint. I remain of the view that, in this decision, I can only consider a complaint about events since 16 May 2018. This is because Mr and Mrs H previously complained about this loan in 2018 and did not refer that complaint to us within six months of Target's response. So matters covered by that complaint are now out of time.

In considering events since then which are in time, I will take into account relevant law, regulations, guidance and codes of practice – as well as what I consider to have been good industry practice at the relevant time – to decide what I consider to be fair and reasonable in all the circumstances of this complaint.

While the previous lender was a regulated firm, the current lender is not. But the lender has appointed Target to administer the loan on its behalf, and Target is a regulated firm. In administering the loan, Target is carrying on the regulated activities of debt administration and debt collection.

Those activities are defined in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, as amended.

The Order defines debt administration as:

taking steps

- (a) to perform duties under a credit agreement ...on behalf of the lender, or*
- (b) to exercise or enforce rights under such an agreement on behalf of the lender*

And it defines debt collecting as:

taking steps to procure the payment of a debt due under a credit agreement

In both definitions, a “credit agreement” has the meaning given in article 60B of the Order. Article 60B(3) says that a credit agreement means:

“... an agreement between an individual or relevant recipient of credit (A) and any other person (B) under which B provides A with credit of any amount”.

There's no requirement for the debt being administered or collected to be a regulated loan – as the definition makes clear, it covers any credit agreement, not just regulated credit agreements.

The loan that is the subject of this complaint is a credit agreement. And in administering it, and collecting the payments, on behalf of the lender, Target is therefore carrying out regulated activities in its own right.

This is an unregulated loan, because it was taken out as a second charge secured loan borrowing more than £25,000 before April 2008. As it's an unregulated loan, the regulatory rules that would otherwise apply to mortgages and lending do not apply in this case.

However, as a regulated firm, Target is subject to the broader principles set out by the Financial Conduct Authority – which include the obligation to “*pay due regard to the interests of its customers and treat them fairly*”. This is part of the regulator's rules and guidance which – along with relevant law, and what I consider to be good industry practice – I am required to take into account in deciding what is fair and reasonable in all the circumstances.

That means that we can consider a complaint about Target about its acts or omissions – what it did but also what it failed to do – in carrying on the regulated activities of debt

administration and debt collection. In other words, we can consider not just the steps Target took; we can also consider whether it should have taken steps but omitted to do so. And in considering that, I can have regard to all the circumstances of the complaint.

In taking steps – or failing to take steps – Target is acting on behalf of the lender. It is exercising the lender's rights, performing the lender's duties, and collecting payments to which the lender is entitled.

But in my view, in doing so Target is required to act fairly and reasonably in all the circumstances. It is not enough for it to say that the lender has a contractual right to do a thing, and therefore in doing that thing on the lender's behalf Target has done nothing wrong. The existence of that contractual right is a relevant consideration, but it is only one factor to take into account in deciding what is fair and reasonable in all the circumstances.

In deciding that, in my view I need to bear in mind that Target is standing in the lender's shoes. As the lender is unregulated, Mr and Mrs H have no recourse (outside the courts) for anything the lender does. But in administering the loan on the lender's behalf, Target has a further, and separate, obligation that comes from carrying on a regulated activity – the obligation to treat Mr and Mrs H fairly and reasonably in all the circumstances.

In my view, just because the lender instructs Target to do something, it does not automatically follow that it will be fair and reasonable for Target to do that thing. And just because the lender omits to instruct Target to do something (or instructs it not to), it does not automatically follow that it will be fair and reasonable for Target not to do it.

In other words, in addition to its obligations to the lender as its appointed administrator, Target also has obligations to treat Mr and Mrs H fairly through its role as a regulated entity. And where those obligations conflict, I'm satisfied it's open to me to direct Target to act fairly and reasonably, and then it's a matter for Target to resolve with the lender any tensions or costs that result.

I've set out the principles I will apply in considering this complaint. I now turn to the substance of the complaint itself.

Mr and Mrs H took this loan out in early 2007, borrowing £40,000 plus £2,750 fees over 25 years. At that time, the interest rate on the loan was 7.67%, and the terms and conditions say that the interest rate is variable. Over the course of the next two years, the interest rate rose gradually to 10.72% by October 2008. It was then reduced to 9.97% in January 2009 – and has remained at that level ever since.

At first, Mr and Mrs H by and large kept up with the loan repayments. Every so often in the early years they would make a payment late. But it wasn't until 2009 that the loan fell into persistent arrears – and even then it was only in arrears by one monthly payment. In late 2010, the arrears began to mount, and the loan was then continually in arrears until 2017.

By then the loan balance had increased to £47,000, despite the payments Mr and Mrs H were making. Over that time, around £3,000 in arrears and legal fees had been added to the balance, and that was part of the reason the balance grew.

However, the main reasons the balance grew were because payments were missed, which meant additional interest was incurred. And, most importantly, the previous lender did not increase the contractual monthly payments to reflect the increased interest rate – it is said that this was because Mr and Mrs H were in arrears at the time.

But whatever the reason for not increasing their contractual monthly payment, its effect on Mr and Mrs H's loan balance was significant. They were being asked to pay £322 per month – which was the payment set at the start of the loan, when the balance was £42,750 and the interest rate was 7.67%. By October 2008, the interest rate was 10.72% - which meant that the interest charged each month was around £380 and rising – but Mr and Mrs H were still only being asked to pay £322.

That meant that each month they weren't even paying enough to clear the interest charged. The balance would increase – and then the next month the balance would be higher still and the shortfall in payments would be bigger. And so on, every month thereafter.

The previous lender recognised this was a problem in 2012, and made a payment of over £5,000 to reduce the balance down to just over £42,000. But it still didn't change the monthly payment, which meant the problem soon started to escalate again. And by 2017, even though Mr and Mrs H had cleared the arrears, the balance was back up over £47,000.

With the exception of the odd late payment, Mr and Mrs H have been out of arrears and making their contractual monthly payment throughout the period from 2017 onwards – yet, by July 2021, their balance had increased again and was by that point over £50,000.

This is because they were still paying the contractual monthly payment set in 2007, when the interest rate and balance were lower. Even after they came out of arrears in 2017 the contractual monthly payment wasn't reviewed and there was no discussion with Mr and Mrs H about how the loan would be paid off by the end of the term when they weren't even paying enough to cover the monthly interest. An explanation was given as part of the 2018 complaint – but no action was taken.

In July 2021, Mr and Mrs H paid £200 at the start of the month, and a further £350 at the end of the month, having missed June's payment. Mrs H spoke to Target on 6 July, and on 7 July Target asked the lender to agree to stop charging interest. The lender agreed on 19 July.

What this means is that from July 2021 onwards, Mr and Mrs H have not been and will not be charged interest on their loan. All the payments they make will be used to reduce the capital balance. And, broadly, this means that the payments they now make (assuming they keep up with them) will be enough to clear the loan balance by the end of the term.

I think this was the fair thing to do. But I agree with our investigator that it should have been done long before July 2021.

Ever since the first increases in the interest rate – two days, and then again five months, after Mr and Mrs H took the loan out – their payments have not been enough to clear the loan balance, because they were being undercharged interest. And by 2008, the interest they were being charged was already in excess of the contractual monthly payment. And so even without the substantial arrears between 2010 and 2017, this loan would never have been paid off by the end of the term. The previous lender corrected the historical position in 2012 – but didn't change the monthly payment going forward.

Target only became the regulated administrator of this loan in 2016. It's not responsible for the actions of the previous lender, or for anything that happened before it became involved in the loan.

But in my view, once Target did become involved, it would have been fair and reasonable for it to look at the loan balance, look at what Mr and Mrs H were paying and what they could afford to pay, and think about whether they were on track to clear the balance – or whether,

in fact, their situation was getting worse as the balance grew month by month. And, if so, what could be done to get things back on track.

In my view it's not enough for Target to say it will not do anything unless and until Mr and Mrs H contact it, assuming they are not in difficulties unless they say so. This is not just a matter of Mr and Mrs H being in financial difficulties but not asking for help (in any case, even in that situation Target has a pro-active obligation to assist them).

This is a situation where, as a responsible administrator acting fairly and reasonably, Target ought to have considered whether the loan was being administered fairly in such a way that Mr and Mrs H would be able to repay it. And it should have been obvious that they would not be able to as things stood.

Had Target given consideration to this issue before July 2021, this is a matter that Target could and should, acting fairly, have raised with the lender. Given the lender agreed to stop interest in July 2021, it may well have agreed to do so sooner – had it been asked to consider it by Target.

In my view, even if Target had contacted the lender before 2021 but the lender had not agreed to stop interest, Target would still need to consider whether, acting fairly and reasonably in all the circumstances, it could administer the loan in that way.

In my experience of the second charge lending market, situations like this are not uncommon – where the lender has in the past not asked for sufficient monthly payments to clear the balance, or where historic arrears have caused the balance to substantially increase such that the effect of charging interest is that the balance continues to grow even where the borrower makes their payments. In such situations, solutions like reducing or freezing interest are a relatively common form of forbearance in the second charge lending market, in my experience. In the right circumstances, doing so can in my view amount to good industry practice.

In the particular circumstances of this case, Mr and Mrs H had been underpaying interest for many years, virtually since the start of their loan (including before they went into arrears). Their contractual monthly payment had never increased, even when the interest rate had done so. And this, coupled with the impact of the past arrears, meant their loan balance was growing month by month even though they were paying what they were being asked to pay.

Since 2017, they've been clear of arrears. But their balance had increased, and as things stood they were not on track to repay the loan by the end of the term.

In that situation, I'd expect a responsible lender – or administrator – acting fairly to review the loan balance, check to see whether the loan was on track to be repaid by the end of the term – and, if not, consider whether there's anything that could be done in light of the borrower's financial situation at that time. Actions might include amending the monthly payment, extending the term, or reducing the interest rate (including to 0%) – or some combination of those.

I've then thought about what would have been fair action to take in the particular circumstances of this case. Taking into account Mr and Mrs H's financial and health situation in 2021, and bearing in mind the way the loan balance had grown rather than reduced over the years since it was taken out, even since they came out of arrears in 2017 – no least because they'd never been asked to pay the right amount – Target rightly concluded in 2021 that freezing the interest was the fair way forward in their particular situation.

As I say, Target ought to have considered this sooner than it did. And if it had done so but the lender had not agreed, and insisted on Target collecting the full interest due under the terms of the contract each month, it would not in my view have been fair and reasonable for Target to do so.

As a regulated entity, Target has its own obligations to treat Mr and Mrs H fairly. And in my view, that includes showing reasonable forbearance and only administering the loan and collecting the debt owed to the lender in a fair and reasonable way. And in the particular circumstances of this case, I don't think continuing to do so in such a way that the balance grew month on month, with no prospect of Mr and Mrs H being able to pay it off, would be fair and reasonable.

I'm satisfied that, in the particular circumstances Mr and Mrs H found themselves in, with the history of this loan and the balance as it stood, after they came out of arrears and were managing the monthly payments, there ought fairly to have been a review of the account. Such a review ought to have considered whether allow Mr and Mrs H would be able to clear the loan balance in an affordable way by the end of the term or taking other action if that were not to be possible – including considering whether it was necessary to exercise forbearance or otherwise make changes to the loan.

Reviewing the account in this way would need to take into account Mr and Mrs H's circumstances at the time as well as the history of the loan and reasons why it was in the position it was in. And I don't think it's fair and reasonable for Target to say that the onus is entirely on Mr and Mrs H to contact it and that it would take no action unless they did so.

I've said that I can't consider the fairness of anything that happened before 16 May 2018, because that is out of time following Mr and Mrs H's earlier complaint. And so I can't consider whether there were opportunities for Target, acting fairly, to have reviewed the account before then.

But I note that on 31 July 2018 – within the time I can consider – Mrs H called Target. She made a manual payment, for more than the contractual monthly payment. Target asked why she was paying more than the contractual payment given the loan was not in arrears. Mrs H said there was no particular reason, and Target noted that it would take no further action.

It seems to me that this was a good opportunity – missed by Target – to have a discussion with Mrs H of the sort I've set out above. It had just responded to a complaint about Mr and Mrs H's worries that the loan wouldn't be repaid on time. In that complaint response, it had explained why this was – but not what it would be willing to do about it. A couple of months after that complaint response, Mrs H paid slightly more than the contractual payment. But Target still did not consider whether, given the balance was growing month by month, whether there was anything it needed to do to help Mr and Mrs H get things back on track so that they were reducing the balance and, ultimately, would be able to pay it off. All it did was ask her why she was paying more than she needed to.

I'm satisfied that Target ought, acting fairly and reasonably in the circumstances of this case, to have taken the action it took in July 2021 sooner, in July 2018. At that time, it ought fairly to have thought about the problem it had told them about a few months earlier and what could have been done about it. And, just as it did in 2021, I'm satisfied that, acting fairly, had it done so it would have concluded that the fair way forward was to have frozen the interest, so that Mr and Mrs H could focus on reducing the capital balance by the end of the term. That conversation with Mrs H was a good opportunity for Target to take that action.

It doesn't seem to me that there was any other realistic option other than reducing the interest rate to 0% at that point. Continuing to charge interest at the contractual rate, and

increasing the monthly payment so that the loan would be paid off by the end of the term, would very substantially increase the monthly payment. In effect, the loan would change from a £42,750 mortgage over a 25 year term to a £50,000 mortgage over a ten year term. I'm not persuaded that would be sustainable for Mr and Mrs H. Nor, given their ages and health situation, would a substantial term extension have been appropriate.

That leaves reducing or freezing interest as the appropriate way forward. And, given the balance and the time left to repay, as well as taking into account the amount Mr and Mrs H had already paid, freezing the interest – reducing the rate to 0% - was the fair way forward. This would allow Mr and Mrs H to repay the capital balance in a sustainable way without substantially increasing their monthly payments. Target ought, acting fairly, to have thought about this in July 2018. I also note that doing this would mean that the amount Mr and Mrs H had already paid plus the outstanding capital balance roughly equalled the amount they would have had to pay over the whole life of the loan had nothing gone wrong.

But Target did not do this in 2018 – and so Mr and Mrs H continued to underpay, and the balance continued to grow, for the next three years. I'm not persuaded that was fair and reasonable. In my view, the fair way to resolve this complaint is to put Mr and Mrs H back in the position they would have been in had Target thought about this and taken fair steps in July 2018.

Mr and Mrs H have also referred to the lender's offer to settle the loan for £15,000 less than the outstanding balance – as long as they paid in full within 30 days. Mr and Mrs H were not in a position to do that. I don't think this offer was unfair of itself. It's not an unusual thing for lenders in this part of the market to do – since it means that the lender gets the benefit of the funds back now rather than waiting for perhaps many years for the balance to be repaid. And it offers a discount to encourage that.

I can see that Mr and Mrs H, in their particular circumstances, found this a rather insensitive offer. And why they thought the same offer should have been made even if they didn't repay in full. But as I say it wasn't unreasonable to offer an incentive for early repayment. And just because Mr and Mrs H weren't in a position to take that offer up, I don't think their balance ought fairly to have been reduced by £15,000 – outside the sorts of reasonable forbearance I've talked about elsewhere in this decision.

Putting things right

To put matters right it's fair and reasonable in the circumstances of this case for Target to put Mr and Mrs H back in the position they would have been in had it reviewed their account and frozen interest in July 2018, not July 2021. It will need to re-work their account and reduce the balance accordingly.

I'm satisfied that, even though Target is not the lender, it's fair and reasonable to expect Target to do this. Target was the entity Mr and Mrs H dealt with, and was responsible for administering their loan – and obliged to do so fairly and reasonably. If it had referred their loan to the lender to consider freezing interest in July 2018 – as it did in July 2021 – it may well be that the lender would have agreed at that time, as in my view acting fairly it ought to have done.

And even if the lender had not agreed, in my view it would not have been fair and reasonable for Target to continue to administer Mr and Mrs H's account on the basis that the interest they were being charged each month exceeded the amount they were paying – so that the loan balance grew even though this was a repayment loan and Mr and Mrs H were paying what they were being asked to pay.

I say that notwithstanding the lender's contractual entitlement to charge interest – taking into account the position Mr and Mrs H were in, the need to offer them reasonable forbearance so they could clear the loan by the end of the term, and the sort of good practice across the second charge lending market to support customers in this situation I've referred to above.

While, as the debt administrator, Target is exercising the lender's rights (including the contractual right to charge interest), that does not in my view override its obligations to act fairly and reasonably to Mr and Mrs H. Continuing to exercise that contractual right in such a way that Mr and Mrs H could never have repaid their debt would not have been a fair and reasonable thing to do. And so even if the lender would not have agreed to freeze interest in 2018, it would not in my view have been fair and reasonable for Target to carry on collecting the loan in that way. As the regulated entity, it falls to Target to treat Mr and Mrs H fairly in how it carries on its regulated activities.

I will therefore direct Target to re-work Mr and Mrs H's loan balance as if interest had been frozen from 1 August 2018 and not charged from then until the end of the term. It should then tell Mr and Mrs H what the revised balance is, and how much they will need to pay each month to clear the loan balance by the end of the term, setting this amount as their new contractual monthly payment.

It is for Target to resolve with the lender how this is to be done. If the lender does not agree to reduce the balance to give effect to my decision, then Target will need to find another way – for example, it could make a payment to the loan itself to reduce the balance now to what it would have been had interest been frozen from 1 August 2018 rather than from 2021.

My final decision

For the reasons I've given, my final decision is that I uphold this complaint and direct Target Servicing Limited to:

- Reduce the balance of Mr and Mrs H's loan so that it is as if interest had been set to 0% on an ongoing basis with effect from 1 August 2018 rather than 2021; and
- Tell Mr and Mrs H how much they will need to pay each month going forwards to clear the loan balance by the end of the term.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs H and Mr H to accept or reject my decision before 28 October 2022.

Simon Pugh
Ombudsman