

The complaint

Mrs C is unhappy that Sainsbury's Bank Plc have applied a default on her credit file following a missed payment on her fixed sum loan agreement.

The complaint has been brought to our service by a solicitor on behalf of Mrs C. For ease of reading, I'll refer to all submissions as made by Mrs C.

What happened

On 16 January 2020, Mrs C called Sainsbury's Bank to change the direct debit date to coincide with her pay day. Sainsbury's Bank told Mrs C the direct debit had already been called for as it was only four days before the payment was due. They explained they required at least 10 days' notice to make amendments to the direct debit.

Mrs C explained that if the direct debit was collected before she was paid, it would cause her financial difficulties. Sainsbury's Bank suggested that Mrs C cancelled her direct debit and make a manual payment after her pay day. They also told Mrs C they'd ensure she wouldn't be charged any fees or interest.

On 28 January 2020, Mrs C called Sainsbury's Bank to make a manual payment and set up the direct debit on her preferred payment date. Sainsbury's Bank told Mrs C that they weren't able to make any changes to the direct debit until her payment had been processed, which would take three to five days and she'd need to call back to change the direct debit date after this.

Mrs C then got in touch with Sainsbury's Bank on 17 February 2020. Sainsbury's Bank weren't able to make the changes to the direct debit as they weren't given 10 days' notice before the direct debit payment was due that month. They agreed with Mrs C she could make a manual payment and set up the direct debit on her preferred payment date from March 2020 onwards.

Sainsbury's Bank didn't receive the manual payment from Mrs C for February 2020 and her account went into arrears by £412.66. Mrs C contacted Sainsbury's Bank in May 2020 to and a payment arrangement was set up for £100 per month for three months, in addition to her monthly repayments. Sainsbury's Bank told Mrs C they'd need to speak to her again at the end of the arrangement to discuss the next steps for the outstanding amount.

When the arrangement ended in August 2020, Mrs C still had an arrears amount of £112.66 to repay. Sainsbury's Bank tried contacting Mrs C, and when they didn't hear from her, they defaulted her account on 29 November 2020.

Mrs C contacted Sainsbury's Bank on 3 December 2020 and brought her account up to date. During this call, she wasn't made aware that her account had already been defaulted. Sainsbury's Bank called her back to inform her.

Unhappy with this, Mrs C raised a complaint. She said she wasn't made aware of the arrears

on the account. She believes the missed payment in February 2020 was due to an internal error with Sainsbury's Bank. And they made a mistake with setting up the repayment plan over three months instead of four, leaving a shortfall of £112.66. She said Sainsbury's Bank took too long to deal with her complaint, and they didn't respond to her letters chasing for a response.

Sainsbury's Bank said Mrs C didn't make a manual payment in February 2020 which put her account into arrears. They explained they didn't make an error in setting up the arrangement plan and were satisfied the default had been applied correctly. They accepted Mrs C should've been told about the default when she called to make the payment, rather than having to call her back. They apologised for the poor service and delays in responding to her complaint. They offered Mrs C £80 compensation.

Our investigator said that Sainsbury's Bank had correctly applied the default and made reasonable attempts to contact Mrs C before doing so. She felt the compensation of £80 fairly recognises the service issues Mrs C experienced. Mrs C disagreed and asked for an ombudsman's decision.

My provisional decision

I issued a provisional decision on 27 July 2022. My findings were as follows:

"Missed direct debit

I've listened to the calls of 16 January, 28 January, and 17 February 2020. Having done so, I'm satisfied Sainsbury's Bank made it clear to Mrs C that she needs to give them 10 days' notice to make amendments to her direct debit. And that Mrs C was aware that she needed to make a manual payment in both January 2020 and February 2020.

As a result, I don't agree that the missed direct debit in February 2020 was due to an error by Sainsbury's Bank as Mrs C has mentioned.

That said, customers use direct debits for the convenience and peace of mind that important bills, such as loan repayments are made on time. Based on what I've seen, I think Sainsbury's Bank made it more difficult for Mrs C to change the direct debit to her preferred payment date. I'll explain why.

Sainsbury's Bank say they couldn't change the direct debit date on 16 January 2020 as they had already called for the payment. And they couldn't set up the direct debit on 28 January 2020 as Mrs C's manual payment hadn't been processed fully which takes three to five days.

However, I can't see why Sainsbury's Bank would've been prevented from setting up a new direct debit instruction from Mrs C on 16 January 2020 to start from February 2020 on Mrs C's preferred date.

I say this because Mrs C's existing direct debit had already been cancelled by Sainsbury's Bank as reflected in their system notes which says:

"...advised cust to cancel down DD with bank to make sure they don't charge cust and I have also closed down DD from our end."

Mrs C's account was up to date and didn't go into arrears until 20 January 2020 when the direct debit payment was due. There was also more than 10 days' notice from 16 January 2020 until Mrs C's preferred payment date in February 2020. So, I think Sainsbury's Bank should've taken instructions from Mrs C to set up a new direct debit from February 2020 onwards. If they had done so, I'm persuaded that it's more likely than not that Mrs C wouldn't have missed the payment in February 2020 as she'd asked the payment to be collected on her pay day.

Allocation of payments

The terms and conditions of Mrs C's agreement sets out the order in which Sainsbury's Bank will use payments to repay the amount owed. It says:

"Allocation of payments

We will use your payments to repay the amount you owe us under this agreement in this order; first towards any amount in arrears you owe because you did not make monthly payments in full when they were due; then towards any monthly payments which are currently due; next, towards any additional arrears interest and late payment fees and lastly, towards reducing the remaining loan amount you owe us."

The statement of account shows that Mrs C made a payment of £412.66 on 27 November 2020. As per the 'Allocation of payments' term under the agreement, Sainsbury's Bank should've allocated part of this payment to first clear the amount in arrears and then towards the monthly payment which was due.

The default notice that was sent to Mrs C on 2 November 2020 asked Mrs C to pay £143.74 by 29 November 2020. Mrs C's payment of £412.66 on 27 November 2020 more than covered the amount she needed to pay to remedy the requirements of the default notice.

I'm satisfied Sainsbury's Bank didn't allocate the payments in line with the terms and conditions. If they had done so, then the payment Mrs C made would've been used to clear the arrears first – meaning the default couldn't have been applied as Mrs C made the payment set out in the notice of default. The notice of default clearly says: "If the action required by this notice is taken before the date shown, no further enforcement action will be taken in respect of the breach."

Therefore, Sainsbury's Bank have acted unfairly in applying the default. I appreciate Sainsbury's Bank have pointed out the approach we've taken on other cases and have queried what action they could've taken in the circumstances. In reaching my decision, I'm not suggesting that Sainsbury's Bank needs to redesign their collections strategy or change their overall approach to dealing with outstanding balances. I'm simply considering the individual circumstances of this particular complaint to decide if the default was applied fairly, and I don't think it was as I've concluded above.

Disproportionality

Section 7 of the Consumer Credit Sourcebook on treatment of customers in default or arrears says that lenders must not take disproportionate action against a customer in arrears or default.

Given that Mrs C was making her contractual payments every month of £412.66 since the start of the agreement and after missing the payment in February 2020, I think applying a default over arrears of £112.66 was disproportionate.

Sainsbury's Bank have pointed out that the guidance from the Information Commissioner's Office (ICO) on recording arrears, arrangements and defaults says that if a customer falls into arrears or they don't keep up to the revised terms of an arrangement, a lender can record a default when the customer is three to six months in arrears.

However, this guidance says that a default may be recorded and as a general guide, it may occur when the customer is three months in arrears and normally by six months in arrears.

This doesn't mean that a lender should immediately apply a default in every case when their customer is three months in arrears. The lender should act pragmatically taking into account the rest of the guidance including this principle and the circumstances of the customer.

The ICO guidance also says that data reported on a credit file must be fair, accurate, consistent, complete and up to date. It wasn't unreasonable for Sainsbury's Bank to continue to record the arrears and the arrangement plan on Mrs C's credit file – this was a true and accurate reflection of how the account was managed.

However, in this particular case, a default is not a fair reflection of Mrs C's situation. A default usually is at a point when a lender decides they're unlikely to get their money back as the consumer isn't able to bring the account back on track. It's also generally an indication to other prospective lenders that the consumer hasn't been able to keep up with contractual payments and may be in financial difficulties.

Mrs C didn't miss her payment in February 2020 as a result of financial difficulties. In fact, the evidence shows that Mrs C has been maintaining her contractual payments of £416.22 before and after the missed payment in February 2020. This isn't a sign that Sainsbury's Bank were unlikely to receive their money back.

I also don't think it's fair to say that the relationship between Mrs C and Sainsbury's Bank had broken down. I say this because the arrears on the account decreased after the arrangement plan and Mrs C continued to make contractual monthly repayments reducing the remaining loan amount.

Sainsbury's Bank also seem happy for Mrs C to continue to make the same repayments despite defaulting the account and the outstanding balance remaining due. This indicates that the relationship hadn't broken down.

With this in mind and since defaulting the account was disproportionate, I don't think it's fair to record the default on Mrs C's credit file. And a lender must record data which is fair – this is one of the principles set out in the ICO guidance.

Putting things right

Ultimately, if Sainsbury's Bank had followed their own terms and conditions in allocating the payments Mrs C made, then the default wouldn't have been applied. In the circumstances of this complaint, I think it's fair and reasonable for Sainsbury's Bank to remove the default and allow Mrs C to continue repaying the loan under the original terms.

Mrs C has asked for compensation for the distress and inconvenience caused to her. While I don't dispute the default on Mrs C's credit file has had an impact on her, I don't think it's fair and reasonable to ask Sainsbury's Bank to compensate her.

I say this because I'm satisfied Mrs C should've mitigated her circumstances. As I've explained above, Sainsbury's Bank made it clear to her that she needs to give them 10 days' notice to amend her direct debit and that she'd need to make a manual payment in January 2020 and February 2020. They also sent her letters on 11 April 2020 and 1 May 2020 regarding the missed payment. So, I think Mrs C could've made the payment sooner to avoid the situation she found herself in.

I've listened to the call of 7 May 2020 when Sainsbury's Bank agreed an arrangement plan with Mrs C. During this call, it was made very clear to Mrs C that the plan was to pay an additional £100 for three months and that she'd need to speak to them again to come to an agreement on how to repay the rest of the arrears.

Even if Mrs C was unclear on the terms of the arrangement plan after the call, Sainsbury's Bank sent her a letter on 8 May 2020 to confirm the details. The letter explained that three payments of £512.66 had been agreed. This should've reasonably made it clear to Mrs C that she hadn't agreed to make four payments to clear the arrears as she recalls.

The letter goes on to explain that if the overpayments don't clear the arrears, then Sainsbury's Bank would need to speak to Mrs C about the account. It confirms that the arrangement will be reviewed again on 2 August 2020 and Sainsbury's Bank would be in touch to talk about how to manage the payments going forward.

Based on this, I think Mrs C should reasonably have been aware of the terms she agreed to and if there was any confusion, she could've spoken to Sainsbury's Bank to clarify this at the time.

Sainsbury's Bank sent Mrs C letters on 2 August 2020, 16 August 2020 and 31 August 2020 prompting her to get in touch to discuss the repayment of the outstanding arrears. I can see from their system notes, they also attempted several phone calls but weren't successful in reaching Mrs C.

On 20 October 2020, Sainsbury's Bank sent a letter giving Mrs C 10 days to get in contact with them regarding the arrears. They explained that the next step if they don't hear from her would be to issue a notice of default and then recording a default on Mrs C's credit file.

Sainsbury's Bank then issued a notice of default on 2 November 2020 asking Mrs C to make a payment of £143.74 before 29 November 2020. And that if payment wasn't received by this date, then further action could be taken against her.

All things considered, I'm satisfied that Sainsbury's Bank made reasonable efforts to get in contact with Mrs C regarding the arrears and she had several opportunities to prevent the default from being applied on her credit file.

The letters Sainsbury's Bank sent to Mrs C were sent to the correct address – the same address given to our service. So, it's unclear why Mrs C didn't receive them. But I can't reasonably blame Sainsbury's Bank for this.

I can see from the system notes provided by Sainsbury's Bank that they made numerous unsuccessful attempts to call Mrs C between August and September. The telephone number they used to contact Mrs C appears to be correct as she confirmed this during the telephone call of 28 January 2020, 17 February 2020 and 9 December 2020.

In any event, Sainsbury's Bank didn't need to call Mrs C before applying a default on her credit file as she's suggested – even though they did try calling her. They're within their rights to communicate with her via letter regarding the arrears on her account as it's one of the methods of correspondence provided by Mrs C. Since Mrs C could've done more to avoid the impact on her, I don't think Sainsbury's Bank should compensate her for the distress and inconvenience she was caused by the default.

I agree Sainsbury's Bank took too long to deal with Mrs C's concerns and she had to chase them for a response. The complaint was first raised on 9 December 2020, but Sainsbury's Bank didn't give their final response until 23 March 2021.

Although Sainsbury's Bank updated Mrs C twice to let her know they were still investigating her concerns, the delays were quite long given that they need to respond to complaints within eight weeks. Mrs C also should've been told about the default when she called Sainsbury's Bank to clear the arrears.

I can understand why this would've been disappointing to Mrs C and caused her unnecessary frustration and annoyance. Sainsbury's Bank have rightly acknowledged this and apologised which I'd expect them to do. They've also offered Mrs C £80 compensation for these customer service issues which I think is fair and reasonable to recognise the distress and inconvenience caused to her.

Mrs C has also asked for her legal costs to be reimbursed to her. I don't think it's fair and reasonable to hold Sainsbury's Bank responsible for legal costs, as it was Mrs C's choice to pursue her complaint through a solicitor. She could've raised her complaint for free with Sainsbury's Bank herself and could've sought advice from free services such as Citizen's Advice. It's also free for anyone to bring a complaint to our service. So, I can't fairly hold Sainsbury's Bank liable for costs which Mrs C incurred when she chose to be represented by a solicitor."

Responses to provisional decision

I invited both parties to respond to my provisional decision with any further submissions.

Sainsbury's Bank said that I had misunderstood what happened on 16 January 2020. They explained the direct debit instruction had already been sent to the paying bank so they couldn't stop it from being collected.

If they had set up the direct debit from February 2020 onwards as I'd suggested in my provisional decision, then it would've been cancelled again after Mrs C contacted her bank to stop the January 2020 payment from being taken. And Mrs C's bank wouldn't have been able to stop just one instalment from being collected.

They explained their system wouldn't have allowed them set up a direct debit for February 2020 when a payment was in flight. And Mrs C would've had to call them again to do so by giving suitable notice.

They say they have been pragmatic and haven't rushed to default Mrs C as the account was in arrears from January until November 2020. They also made numerous attempts to contact Mrs C.

They queried what limit our service deems as suitable to apply a default as they're expected to take learnings from our decisions. They explained the monthly payments Mrs C made of £416.22 wasn't enough to clear the arrears of £112.66 to bring the account up to date.

And that the letters they sent showed the outstanding balance on the account at the time and this balance increases as further payments become due. They don't feel the letters should be read in isolation and out of context, nor do they agree that they gave the impression that the contractual monthly payments would clear the arrears or stop the default.

And if they did, as I suggested, in my provisional decision and used the contractual monthly payments to clear the arrears each month and effectively restart the debt chase each month, then the account could potentially stay in arrears indefinitely which goes against the guidance and expectations set out by the FCA and ICO.

They asked what action we would've expected them to take when the account was in arrears for a prolonged period and Mrs C wasn't responding to them. They explained they had no way of knowing that Mrs C would eventually respond and feel it was the confirmation of the default which prompted her to get in touch. They said Mrs C had benefitted from the default as interest has stop being applied.

They felt the provisional decision goes against what our service have previously said and asked for a final decision to be published so other lenders are made aware of our expectations and can also take learnings.

Mrs C didn't respond within the deadline given.

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 think it's important to clarify that in reaching my decision here, I've only considered the circumstances of Mrs C's complaint and not the outcome we've reached on other cases. Sainsbury's Bank will already be aware that we make decisions that are fair and reasonable on a case-by-case basis.

The comments Sainsbury's Bank have made aren't new and I'd already considered them when reaching my provisional decision. So, I don't intend to respond or address each point raised.

Ultimately, it boils down to two things here:

1. What do the terms and conditions of the agreement say about how payments will be allocated?
2. What did the default notice require Mrs C to do to remedy the breach?

As explained in my provisional decision, the terms and conditions of the agreement says that Sainsbury's Bank will use Mrs C's payments to repay any amounts in arrears first then towards any monthly payments which are due.

This means Sainsbury's Bank should've used the monthly contractual payments Mrs C made to clear the arrears on her account first – even if this re-started the debt cycle as they've mentioned. This is what they have set out in their terms and conditions on how they'll allocate payments received.

The notice of default Sainsbury's Bank sent to Mrs C on 2 November 2020 said:

"You agreed under your loan agreement that you would pay each monthly payment in full on its due date, as well as any late payment fees and additional arrears interest. Because you have missed payments you are now in breach of your loan agreement and the arrears of monthly instalments, late payment fees, and additional arrears interest amounting to £143.74 are now due and outstanding."

It explained what Mrs C needed to do:

"To remedy the breach and put things right, you must pay the total arrears of £143.74 before 29 November 2020..."

IF THE ACTION REQUIRED BY THIS NOTICE IS TAKEN BEFORE THE DATE SHOWN NO FURTHER ENFORCEMENT ACTION WILL BE TAKEN IN RESPECT OF THE BREACH."

I'm satisfied Mrs C made a payment of £412.66 to Sainsbury's Bank on 27 November 2020. While she made this payment as part of her contractual monthly payment, it was the responsibility of Sainsbury's Bank to ensure they allocated the payment correctly towards clearing Mrs C's arrears first which is in line with the terms and conditions of the agreement.

The action required by the default notice was for Mrs C to pay Sainsbury's Bank £143.74 by 29 November 2020. I don't agree that the default notice should be read in conjunction with other letters.

I don't think it's reasonable to somehow understand from the default notice that a default would still be applied if the arrears and the contractual payment for that month wasn't made. To the contrary, the default notice says no further action will be taken if Mrs C made a payment of £143.74 before the date on the notice.

The Consumer Credit Act 1974 section 89 says:

"Compliance with default notice.

If before the date specified for that purpose in the default notice the debtor or hirer takes the action specified under section 88(1)(b) or (c) the breach shall be treated as not having occurred."

This means, if Mrs C took the action specified in the notice of default – in this case, to pay £143.74 before 29 November 2020, then Sainsbury's Bank shouldn't apply the default as they should treat the breach of the loan agreement as remedied.

As explained, I'm satisfied Mrs C took the action required by the default notice and therefore had remedied the breach of her loan agreement. Had Mrs C failed to make the payment on 27 November 2020, then it's likely Sainsbury's Bank would've been right to apply the default on her credit file.

But given that Mrs C paid more than the amount required by the default notice, and the allocation of payment term within the terms and conditions say that payments will be allocated to arrears first, I'm satisfied Sainsbury's Bank didn't apply the default fairly.

Sainsbury's Bank have made the point that Mrs C has benefited from the interest stopping following the default. I agree Mrs C shouldn't have a financial benefit as a result of this situation.

Therefore, as I proposed in my provisional decision, Sainsbury's Bank should allow Mrs C to continue repaying the loan as per the original terms and conditions. This means Sainsbury's Bank can apply any interest which Mrs C would've been liable for under the agreement, had the account not been defaulted.

I appreciate Sainsbury's Bank want clarification about what limits they should set before defaulting an account, and on what further steps they should've taken in a situation like this. Specifically, where the account was in arrears for a prolonged period, but Mrs C wasn't responding.

Sainsbury's Bank are entitled to decide their own limits for applying a default and steps to take to recover arrears. But this doesn't mean that the limit they set or steps they take would be fair in every case. Depending on the circumstances, it might be disproportionate, and I've found it to be the case here as I've explained in my provisional decision.

While Mrs C didn't respond to the calls or letters from Sainsbury's Bank, she did continue making the contractual payments towards the account. So, the relationship between the two parties wasn't broken down as Sainsbury's Bank have said.

Overall, I'm satisfied with the conclusion I reached in my provisional decision and I haven't changed my mind on how this complaint should be resolved.

To put things right, Sainsbury's Bank should:

- Remove the default from Mrs C's credit file;
- Allow Mrs C to continue repaying the loan under the original terms and conditions;
- Pay Mrs C £80 compensation for the distress and inconvenience caused, if they haven't already done so.

My final decision

For the reasons I've explained, my final decision is that Sainsbury's Bank Plc should put things right in the way I've set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs C to accept or reject my decision before 22 September 2022.

Ash Weedon
Ombudsman