DRN-3825614

Complaint

Mr C has complained that Zopa Limited ("Zopa") unfairly arranged for him to be provided with unaffordable loans. He says the appropriate checks weren't carried out and this led to him being provided with unaffordable loans.

Background

Zopa operated the electronic system in relation to lending which led to Mr C being provided with a first loan in March 2017. The loan was for £6,000.00. Mr C settled this loan early with some of the proceeds from a second loan for £10,000.00 which Zopa arranged in November 2017. Both of these loans had repayment terms of 36 months.

Zopa arranged a third loan for £16,000.00 in July 2018 and some of the proceeds from this loan settled the second loan. Finally, Zopa arranged a fourth loan in February 2019, which was for £24,000, and some of the proceeds from this loan were used to pay loan 3. Loans 3 and 4 had 60-month terms.

Mr C's complaint was reviewed by one of our investigators. She thought that Zopa hadn't done anything wrong or treated Mr C unfairly when bringing about these loans. So she didn't uphold the complaint.

Mr C disagreed with our investigator's view. So the complaint was passed to an ombudsman for review.

My provisional decision of 11 November 2022

I issued a provisional decision – on 11 November 2022 - setting out why I intended to partially uphold Mr C's complaint. I won't copy that decision in full, but I will instead provide a summary of my findings.

I started out by saying that we've set out our general approach to complaints about unaffordable/irresponsible lending - including the key rules, guidance and good industry practice - on our website. And that I had used this approach to help me decide Mr C's complaint.

Having carefully thought about everything, I thought that there were three overarching questions that I needed to answer in order to fairly and reasonably decide Mr C's complaint.

These three overarching questions were:

- Did Zopa complete reasonable and proportionate checks to satisfy itself that Mr C would be able to meet his obligations under the P2P agreements in a sustainable way?
    - If so, did it make a fair decision?
    - If not, would those checks have shown that Mr C would've been able to do so?

- Bearing in mind the circumstances, at the time of each application, was there a point where Zopa ought reasonably to have realised Mr C's indebtedness was being increased in a way that was unsustainable or otherwise harmful and so it shouldn't have arranged further loans?

- Did Zopa act unfairly or unreasonably in some other way?

I started out by considering the first of these questions.

<u>Did Zopa complete reasonable and proportionate checks to satisfy itself that Mr C would be able to meet his obligations under the P2P agreements in a sustainable way?</u>

I explained that the rules, regulations and good industry practice in place when Zopa brought about these P2P agreements with Mr C required it to carry out a reasonable and proportionate assessment of whether he could afford to repay his loans in a sustainable manner. This assessment is sometimes referred to as an "affordability assessment" or "affordability check".

The checks had to be "borrower" focused – so Zopa had to think about whether repaying the loans sustainably would cause difficulties or adverse consequences for Mr C. In practice this meant that Zopa had to ensure that making the payments to the loan wouldn't cause Mr C undue difficulty or adverse consequences. In other words, it wasn't enough for Zopa to simply think about the likelihood of Mr C making payments, it had to consider the impact of loan repayments on Mr C.

Checks also had to be "proportionate" to the specific circumstances of the application. In general, what constitutes a proportionate affordability check will be dependent upon a number of factors including – but not limited to – the particular circumstances of the consumer (e.g. their financial history, current situation and outlook, and any indications of vulnerability or financial difficulty) and the amount / type / cost of credit they are seeking. Even for the same customer, a proportionate check could look different for different applications.

In light of this, I thought that a reasonable and proportionate check ought generally to have been *more* thorough:

- the *lower* a customer'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 term of the loan (reflecting the fact that the total cost of the credit is likely to be greater and the customer is required to make payments for an extended period); and

- the *greater* the number and frequency of loans, and the longer the period of time during which a customer has been given loans (reflecting the risk that repeated refinancing may signal that the borrowing had become, or was becoming, unsustainable).

Finally I then explained that there could also be other factors which could influence how detailed a proportionate check should've been for a given application – including (but not limited to) any indications of borrower vulnerability and any foreseeable changes in future circumstances.

I then thought about all of the relevant factors in Mr C's case.

Were Zopa's checks reasonable and proportionate?

Zopa said that it completed an income and expenditure assessment with Mr C before arranging all of these loans. It said that it considered it did enough to establish that all of these loans were affordable. I went on to consider what Zopa did for each loan and the position at the respective times, individually.

- Loan 1

Loan 1 was for £6,000.00, had an APR of 3.8% and was due to be repaid in 36 monthly repayments of £176.54.

From what I could see Mr C was asked about details of annual income which he confirmed as £39,000.00, his residential status, to which he confirmed he was a homeowner and what he paid to his mortgage each month, which was £890. It looked like Zopa also carried out a credit check which showed that he had three credit cards, which were all well within their respective credit limits and an overdraft which wasn't being used either.

So I thought it fair to say that the credit search carried out on Mr C showed that his existing credit commitments were well managed. I also understood that the purpose of this loan was recorded as debt consolidation and given this loan had a low APR of only 3.8% Mr C would save quite a bit on interest payments if he used the funds to clear his credit card balances and closed the accounts.

I did accept that Zopa may not have asked Mr C for further information about his other household bills and expenditure. However, given what was left over from his monthly income once his mortgage payments and payments to existing credit commitments were deducted, I was satisfied that a detailed breakdown of Mr C's non-credit related expenditure wasn't necessary here.

So bearing in mind that Zopa obtained a reasonable amount of information on Mr C's circumstances and there wasn't anything inconsistent in what was gathered, I was satisfied that it did carry out reasonable and proportionate checks before bringing about loan 1 for Mr C. And given that these checks showed Mr C had sufficient disposable income to make the required payments, I was also satisfied that Zopa acted fairly and reasonably when bringing about loan 1 for Mr C.

- Loan 2

Loan 2 was for £10,000.00, had an APR of 2.8% and was due to be repaid in 36 monthly repayments of £289.95. £4,73.02 of the funds from this loan went towards repaying the outstanding balance on loan 1.

I thought that it was worth noting that loan 2 was taken out only a few months after loan 1. And from what I could see Zopa carried out similar checks to what it had done for loan 1. Mr C once again confirmed he had an annual salary of £39,000.00 and that he was a homeowner with mortgage payments of £890 a month. Zopa's credit check also showed that Mr C still had three credit cards and an overdraft which wasn't being used. However, I also thought that what should have been clear to Zopa was the fact that the funds from loan 1 weren't used to clear the largest balance on Mr C's credit cards – or if it was Mr C had subsequently run up a balance of almost £6,000.00 again.

So while on the face of things, the credit search carried out on Mr C showed that his existing credit commitments were still being well managed, bearing in mind the circumstances, I thought that there were some emerging warning signs – Mr C's outstanding credit card balance and him returning for a second loan so quickly – which Zopa ought to have noted. This was especially the case as the purpose of this loan was also recorded as debt consolidation. I did accept that this purpose may have been recorded because a significant proportion of the funds were going towards settling the outstanding balance on loan 1. But nonetheless I would have expected Zopa to have kept the emerging warning signs I'd highlighted in mind should Mr C have returned for further lending.

Once again, it appeared as though Zopa did not ask Mr C for further information about his other household bills and expenditure. However, given what was left over from his monthly income once his mortgage payments and payments to existing credit commitments were deducted, I remained satisfied that a detailed breakdown of Mr C's non-credit related expenditure wasn't necessary here – especially as the monthly payments weren't that much more than for loan 1.

So bearing in mind Zopa obtained a reasonable amount of information on Mr C's circumstances and while there were a couple of things to monitor going forwards, I was satisfied that it did carry out reasonable and proportionate checks before bringing about loan 2 for Mr C. And given that these checks showed Mr C had sufficient disposable income to make the required payments, I was also satisfied that Zopa acted fairly and reasonably when bringing about loan 2 for Mr C.

- Loan 3

Loan 3 was for £16,000.00, had an APR of 3.1% and was due to be repaid in 60 monthly repayments of £288.18. £8,135.48 of the funds from this loan went towards repaying the outstanding balance on loan 2.

Loan 3 was also only taken out only a few months after loan 2. And Zopa still only carried out similar checks to what it had done for loans 1 and 2. Mr C once again confirmed he had an annual salary of £39,000.00 and that he was a homeowner with mortgage payments of £890 a month. Zopa's credit check also showed that Mr C still owed over £6,000.00 on credit cards despite having already been provided with two loans to consolidate his existing debts.

I thought that our investigator had placed a great deal of weight on the fact that Mr C settled loan 1 as promised and that this meant it was reasonably entitled to conclude that Mr C would consolidate his existing debts. But I didn't think that Mr C's settlement of his earlier Zopa loan merited much consideration at this stage as Zopa would automatically have cleared the balance on loan 1 and only released the surplus funds from loan 2 when approving that loan. So I wasn't persuaded that loan 1 having been settled meant that Zopa was reasonably entitled to believe that Mr C would use this loan for the stated purpose of debt consolidation – especially as he hadn't appeared to have cleared his credit card balances.

While I was satisfied that Mr C's failure to have cleared his credit card balances at the time of loan 2 was a warning sign to have been monitored going forward, I thought that Mr C's continuing credit card debt was a cause for concern by the time of loan 3. And in these circumstances, I was satisfied that it was no longer fair and reasonable for Zopa to assume Mr C had enough left over to meet his non-credit related living costs.

In my view, Mr C's increasing indebtedness ought to have prompted Zopa to have asked further questions about his living costs and regular non-credit related expenditure in order to have obtained an understanding of why Mr C hadn't proved able to clear his credit card debts despite having been provided with the funds to do so on more than one occasion.

As there was no evidence that Zopa did find out more about Mr C's circumstances, or that it asked Mr C to provide anything more than he had done for loans 1 and 2 despite him having applied for funds for a third time in just over a year, I set out that it was my intention to find that it didn't complete fair, reasonable and proportionate affordability checks before arranging loan 3 for Mr C.

- Loan 4

Loan 4 was for £24,000.00, had an APR of 3.4% and was due to be repaid in 60 monthly repayments of £435.39. £14,529.50 of the funds from this loan went towards repaying the outstanding balance on loan 3.

The period between loan 3 and loan 4 was also less than the period between loan 3 and loan 2. And I also thought that Zopa ought to have been concerned that this was Mr C's fourth loan in less than two years. Yet, other than taking further steps to ascertain Mr C's income which showed it was less than had been declared, I couldn't see that Zopa did much more than what it had done before arranging loans 1, 2 and 3.

Mr C once again confirmed he had an annual salary of £39,000.00. This time Zopa's further checks showed he only actually earned £36,750.00 and he was a homeowner with mortgage payments of £890 a month. Zopa's credit check also showed that Mr C now owed approaching £8,000.00 on his credit cards despite having been provided with significant funds to clear his existing debts. And yet Zopa still considered that it was fair and reasonable to assume Mr C had enough left over to meet his non-credit related living costs despite all of this.

This was despite Zopa's own records showing that Mr C's debt to income ratio now stood at 61.15%. It was my view that Mr C's increasing indebtedness, over a short-period of time, ought to have caused Zopa concern. And not only should it have asked Mr C further questions about his living costs and regular non-credit related expenditure, I thought that Zopa now needed to take further steps to at the very least cross-check whatever Mr C said about his expenditure, like it did for his income. Zopa could have done this by asking for information such as bank statements or copies of bills. And when it obtained this information it needed to properly scrutinise it and ensure that Mr C did have enough funds to be able to make the payments before it arranged this loan.

As there was no evidence that Zopa did find out more about Mr C's circumstances, or that it asked Mr C to provide much more than he had done for loans 1, 2 and 3 despite his, what on the face of things appeared to be, rapidly increasing indebtedness, I stated that it was my intention to find that it didn't complete fair, reasonable and proportionate affordability checks before arranging loan 4 for Mr C.

Bearing in mind the circumstances, at the time of each application, was there a point where Zopa ought reasonably to have realised Mr C's indebtedness was being increased in a way that was unsustainable or otherwise harmful and so shouldn't have arranged further loans?

I then went on to explain that where a firm failed to carry out reasonable and proportionate checks before arranging a loan or loans, I'd usually go on to recreate reasonable and proportionate checks in order to get an indication of what such checks would more likely than not have shown.

However, I didn't recreate individual, proportionate checks for loans 3 and 4 because I didn't think that it was necessary to do so. I explained that this was the case because in addition to assessing the circumstances behind each *individual* loan arranged for Mr C by Zopa, I also considered it is fair and reasonable to look at the *overall pattern* of lending and what unfolded during the course of Mr C's history with Zopa.

I was mindful here that the relevant rules and guidance made it clear that a firm shouldn't continue arranging further lending where the loans were unsustainable or otherwise harmful and/or it was apparent that the customer may be experiencing financial difficulties.

And I thought that by loan three, Zopa ought fairly and reasonably to have realised that Mr C's financial position was such that further loans were simply unsustainable for him. I had already set out most of the reasons for this in the section on why I didn't think that Zopa's checks, for these loans, were reasonable and proportionate. But the factors which lead me to conclude that Zopa ought fairly and reasonably to have realised loans three and four were unsustainable or otherwise harmful were:

- Mr C's outstanding debt on revolving credit accounts, which he'd supposedly taken loans 1 and 2 to clear. Mr C's persistent revolving credit indebtedness despite having been advanced at least £10,000.00, in new funds, prior to loan three ought to have been concerning.

- the balances on Mr C's revolving credit accounts had increased to their highest ever amount by the time of loan 4 despite the further funds provided for loan 3.

- Mr C's debt to income ratio was increasing. At the time of loan 3 Mr C's debt to income ratio was 38.05% and when loan 4 was provided this climbed further to 61.15%. This is in itself was arguably unsustainable.

In my view, all of the above were clear indicators of Mr C being in a deteriorating financial position. I thought that Zopa may have gone on to argue that Mr C had a good repayment record and this justified arranging the further loans. But I thought that this ignored the fact that Mr C settled loans 1,2 and 3 with funds from further loans. And bearing in mind Zopa's obligation to monitor Mr C's repayment record and offer assistance should it appear that he might've been experiencing financial difficulties, which borrowing further to repay normally indicates, I thought that Zopa should've offered assistance and/or a product that would allow him to sustainably repay what he owed.

But instead of doing this, Zopa consolidated Mr C's borrowing into further loans for even larger amounts. Indeed Mr C started out with a loan requiring 36 monthly payments of around £176 in March 2017. At this time including his prospective Zopa loan, Mr C's total outstanding debt liabilities were around £12,100.00.

By comparison, at the time of loan 4, just over two years later, Mr C was required to make payments of around £435 for another five years. Mr C's total outstanding debt liability was also approaching £32,000.00. And this was despite Mr C having already made payments of almost £5,200.00 (not including what was repaid with later loans) to Zopa in the two years from March 2017. I considered that this all indicated a rapid and unsustainable growth.

I was also concerned about the effect consolidating loans 2 and 3 into loans 3 and 4 respectively had on the overall costs Mr C had to repay. Mr C's loans will have followed a typical amortisation schedule. In the early stages of the loan a significant proportion of Mr C's monthly payments were going towards repaying the accrued interest. And as loans 2 and 3 were settled within months of being provided (with the proceeds from new loans), a significant proportion of his monthly payments would have repaid interest rather than reduced his balance.

Furthermore, the interest rate on loan 3 was higher than on loan 2. And the interest rate on loan 4 was higher than on loan 3. So Zopa's consolidation of Mr C's balances on previous loans in this way meant that he would pay more in interest even leaving aside the fact that the amortisation schedule – for Mr C's existing outstanding balance - would reset or restart each time a consolidation loan was provided. And not only did Mr C owe Zopa more after he was provided loan 4, he also needed to repay this at a higher rate of interest.

In my view, Mr C's 'repayment record' and Zopa granting further loans moved Mr C further and further away from the eventual debt-free position consolidation loans were, in theory at least, supposed to leave a borrower at the end.

Overall and having considered everything, I set out that it was my intention to issue a final decision finding that Zopa ought fairly and reasonably to have realised that loans 3 and 4 were unsustainable or otherwise harmful for Mr C and unfairly and excessively increased his overall indebtedness. As this was the case, this left me intending to issue a final decision finding that Zopa failed to act fairly and reasonably towards Mr C when bringing about loans 3 and 4 for him.

Did Zopa act unfairly or unreasonably towards Mr C in some other way?

I carefully thought about everything provided. Having done so, I hadn't seen anything that led me to conclude Zopa acted unfairly or unreasonably towards Mr C in some other way.

So I explained that I wasn't intending to find that Zopa didn't act unfairly or unreasonably towards Mr C in some other way.

Conclusions

Overall and having carefully thought about the three overarching questions, set out in my provisional decision, I set out that I was intending to issue a final decision finding that Zopa:

- *did* complete reasonable and proportionate checks on Mr C to satisfy itself that he was able to repay loans 1 and 2 and that it made fair and reasonable decisions to arrange these loans;

- *didn't* complete reasonable and proportionate checks on Mr C to satisfy itself that he was able to repay loans 3 and 4;

- ought fairly and reasonably to have realised that loans 3 and 4 were unsustainable or otherwise harmful for Mr C and so shouldn't have been arranged as they would more likely than not unfairly and excessively increased his overall indebtedness;

- *didn't* also act unfairly or unreasonably towards Mr C in some other way.

The above findings meant that I intended to issue a final decision finding that Zopa unfairly and unreasonably brought about loans 3 and 4 for Mr C in July 2018 and February 2019 and that it needed put things right.

Responses to my provisional decision

Zopa confirmed that it accepted my provisional decision and that it didn't have anything further to add.

Mr C confirmed that he accepted my provisional decision and that he had nothing further to add either.

My findings

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

I thank the parties for their responses to my provisional decision. And in particular I'm pleased to see that the parties have accepted my findings.

As the parties have agreed with the findings I reached in my provisional decision and in it I set out in some detail why I intended to uphold Mr C's complaint, I've not been persuaded to alter my conclusions. So I'm still partially upholding Mr C's complaint. And I remain satisfied that Zopa needs to put things right.

Fair compensation – what Zopa needs to do to put things right for Mr C

Having considered everything, I think it would be fair and reasonable in all the circumstances of the case for Zopa to put things right for Mr C in the following way:

- refund all the interest, fees and charges Mr C paid on loan 3;

- add interest at 8% per year simple on any refunded interest, fees and charges for loan 3 from the date they were paid by Mr C to the date of settlement†;

- removing all interest, fees and charges applied to loan 4 from the outset. The payments made should be deducted from the new starting balance – the £24,000.00 originally lent. Zopa should treat any payments made should the new starting balance be cleared as overpayments. And any overpayments should be refunded to Mr C. If an outstanding balance remains on loan 4 after these adjustments, Zopa can use the compensation due for loan 3 to reduce and clear this balance.

- remove any adverse information recorded on Mr C's credit file as a result of loan 3. And if no outstanding balance remains on loan 4 after all adjustments have been made any adverse information recorded on Mr C's credit file as a result of loan 4 should also be removed.

† HM Revenue & Customs requires Zopa to take off tax from this interest. Zopa must give Mr C a certificate showing how much tax it has taken off if she asks for one.

If after all of the above adjustments have been made (including offsetting the compensation for loan 3) an outstanding balance remains on loan 4, Zopa should set up an affordable payment plan for Mr C. I'd also remind Zopa of its obligation to exercise forbearance and due consideration if it intends to collect on an outstanding balance, should one remain after all adjustments have been made to the account, and it’s the case that Mr C is experiencing financial difficulty.

My final decision

For the reasons I’ve explained, I’m partially upholding Mr C’s complaint. Zopa Limited should put things right for Mr C in the way I’ve set out above.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr C to accept or reject my decision before 29 December 2022.

Jeshen Narayanan
Ombudsman