

The complaint

Miss S has complained that Studio Retail Limited (“Studio”) irresponsibly lent to her

What happened

Miss S opened a shopping account with Studio in June 2019. Her account had an initial limit of £200 which was increased in November 2019 to £600.

Miss S says that Studio shouldn’t have lent to her. She says that she was in financial difficulty and Studio should have done more to find out if the credit was affordable for her. Studio says it did all the necessary checks before it lent to Miss S – and when it increased her credit limit.

Our investigator thought that Miss S’s complaint should be upheld. Miss S was subject to a debt relief order (DRO) when she took out the credit which indicates that she wasn’t able to sustainably repay her existing credit. Our investigator said that Studio should have done more extensive checks before it lent to Miss S and that if it had done so, it would have realised Miss S couldn’t afford any more borrowing.

Our investigator said that Studio should pay back interest and charges it made as a result of the credit that was unfairly extended to Miss S.

Miss S agreed with this outcome. Studio didn’t agree. It said that Miss S met its lending criteria and none of her account activity indicated any financial pressure or material financial difficulty.

As Studio didn’t agree, the case has been passed to me to make a decision.

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.

We’ve set out our general approach to complaints about unaffordable and irresponsible lending - including the key relevant rules, guidance and good industry practice - on our website and I’ve taken that into account when considered Miss S’s complaint.

Studio needed to take reasonable steps to ensure that it didn’t lend irresponsibly. In practice this means that it should have carried out proportionate checks to make sure Miss S could afford to repay what she was being lent in a sustainable manner. These checks could take into account a number of different things, such as how much was being lent, the repayment amounts and Miss S’s income and expenditure. With this in mind, in the early stages of a lending relationship, I think less thorough checks might be reasonable and proportionate.

But certain factors might point to the fact that Studio should fairly and reasonably have done more to establish that any lending was sustainable for Miss S. These factors include Miss S's income, her existing borrowing, the frequency of borrowing and the length of time Miss S had been indebted. There may even come a point where the lending history and pattern of lending itself clearly demonstrates that the lending was unsustainable.

Studio has provided a copy of the results of the checks it did at the time it opened Miss S's account. The data showed that Miss S didn't have any credit accounts in arrears and that there was no negative publicly recorded information, such as bankruptcy or an IVA. The checks were unable to verify Miss S's declared income of £24,000 but Studio used Office of National Statistics data to model Miss S's disposable income and concluded that she would have had £703 a month. It knew of her DRO and also that she was 'high risk' under other measures it used. It says it weighed negative information against the positive information it held.

However, I don't think the way Studio weighed the information was fair. Studio was aware of Miss S's active DRO. It says such arrangements were not taken into account by its scoring model at the time but were included as a 'risk of financial difficulties' indicator. The criteria for a DRO are such that Miss S would have had to have been in serious financial difficulty to be eligible for one. DROs are a solution to deal with personal debts someone cannot pay and involves the person ceasing to make any payments towards existing debts listed in the DRO. To obtain a DRO a person must have not enough income to meet their debt repayments and, generally, to have less than £75 a month in disposable income.

Clearly such an arrangement would not be approved if Miss S had genuinely had £703 a month in disposable income as Studio suggests its checks revealed.

The presence of the DRO alone should have been sufficient information for Studio to consider it ought to do more to check Miss S's ability to make her repayments sustainably. I do not consider that the positive information Studio had about Miss S's circumstances, including her utilisation of other credit, was capable of outweighing the knowledge of the DRO.

I think Studio ought to have verified information about Miss S's income and expenditure. Had it done so, I think it would have concluded that Miss S could not afford any more borrowing, even if (as is the case here) the repayments each month would be relatively low. I say this because Miss S has provided copies of her bank statements in the months leading up to the initial borrowing. Of course, she wasn't paying anything towards her existing debts because she was subject to the DRO. But she was still struggling to make payments for essential expenditure such as utility and insurance payments, with eleven direct debit payments returned unpaid in the four month period before the application for the Studio account.

I think Studio ought to have done more to establish that Miss S could repay the borrowing sustainably. I don't think it conducted reasonable and proportionate checks and I don't think Miss S was able to make sustainable repayments on any additional credit at the time of her application.

I think Miss S lost out as a result – by paying interest and charges on the lending. So, I think Studio acted unfairly when it lent to Miss S.

In relation to Miss S's subsequent credit limit increase, I haven't seen anything to suggest that Miss S's financial circumstances improved significantly in the intervening period. Indeed, Miss S remained subject to the DRO until May 2022 – much longer than such an order usually exists. I am not satisfied that the credit limit increase was affordable or the repayments sustainable either.

Putting things right

I think it's fair and reasonable for Studio to refund any interest and charges incurred by Miss S as a result of the credit unfairly extended to her. Therefore, Studio should rework the account and:

1. Refund all the interest and charges Miss S has paid to date.
2. If the borrowing is still in place, Studio should reduce the capital balance by the amount calculated at step 1.
3. If, after step 2, there remains an outstanding capital balance, Studio should ensure that it isn't subject to any historic or future interest and/or charges. But if step 2 leads to a positive balance, the amount in question should be given back to Miss S and 8% simple interest * should be added to the surplus.
4. Studio should remove any adverse information recorded on Miss S's credit file as a result of the interest and charges.

*HM Revenue & Customs requires Studio to deduct tax from any award of interest. It must give Miss S a certificate showing how much tax has been taken off if she asks for one. If it intends to apply the refund to reduce an outstanding balance, it must do so after deducting the tax.

My final decision

I think Studio Retail Limited acted unfairly when it extended credit to Miss S. To put this right I direct Studio Limited to pay compensation as explained above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Miss S to accept or reject my decision before 7 July 2023.

Sally Allbeury
Ombudsman