DRN-4784372

The complaint

Mr R is complaining about Zopa Bank Limited because he says it lent irresponsibly by giving him a loan he couldn't afford.

What happened

Following his application, in May 2013, Mr R was given a loan with Zopa for £15,000. The loan was repayable over 3 years with a monthly payment of £585, based on an interest rate of 26.27%. I understand Mr R stopped making payments after approximately six months and the loan is now in arrears.

Our investigator concluded the complaint should be upheld. She didn't think Zopa carried out an appropriate affordability assessment and that further checks would have shown the repayments weren't affordable in view of Mr R's income and expenditure commitments.

Zopa didn't accept the investigator's assessment and made the following key points:

- The application details were verified via Equifax for up to 12 months before the date of application. No cause for concern was identified so no further checks were required.
- The loan was meant to be used to consolidate existing debt. Mr R would now be in a better position if it had been used for this purpose.

The complaint has now been referred to me for review.

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.

Having done so, I've reached the same overall conclusions as the investigator, and for broadly the same reasons. If I haven't commented on any specific point, it's because I don't believe it's affected what I think is the right outcome. In considering this complaint I've had regard to the relevant law and regulations; any regulator's rules, guidance and standards, codes of practice, and what I consider was good industry practice at the time.

Before lending to Mr R, Zopa was required to carry out appropriate checks to ensure the repayments were affordable and sustainable. To decide whether this requirement was met, the key questions I need to consider are:

- Did Zopa complete reasonable and proportionate checks to establish Mr R would be able to repay the loan in a sustainable way?
- If so, was the decision to lend fair and reasonable?
- If not, what would reasonable and proportionate checks have discovered, and would

the decision to lend have been fair and reasonable in light of that information?

The rules, regulations and good industry practice in place at the time the loan was approved required Zopa to carry out a proportionate and borrower-focused assessment of whether Mr R could afford the repayments. This assessment also had to consider whether the loan could be repaid sustainably. In practice this meant Zopa had to satisfy itself that making payments to the loan wouldn't cause undue difficulty or adverse consequences. In other words, it wasn't enough to simply think about the likelihood of him making payments, it had to consider the impact of the repayments on Mr R.

The affordability assessment and associated checks also had to be proportionate to the specific circumstances. What constitutes proportionate checks depends on a number of factors including, but not limited to, the particular circumstances of the consumer (for example their financial history, current situation and outlook, and any indications of vulnerability or financial difficulty) and the amount, type and cost of the credit being considered. Even for the same customer, a proportionate check could be different for different applications.

Zopa has described the information it gathered to assess whether Mr R's loan was affordable before it was approved. This included:

- information contained in his application, including residential status, employment status and his income, which was separately verified; and
- information obtained from a credit reference agency (CRA), giving details of his existing credit arrangements and any past issues with credit, including missed payments and defaults

Zopa maintains its affordability assessment was proportionate to the loan being given and demonstrated it was affordable.

After carefully reviewing the information Zopa obtained, I note it doesn't appear to have assessed his outgoings other than his existing credit commitments, which I think would have been an important consideration for a loan of this size with such a significant monthly repayment. Further, I think there were factors that were identified by the checks Zopa did complete that should have prompted it to carry out further checks before approving Mr R's loan. I don't agree the affordability assessment was reasonable and proportionate in this case and I think a combination of the following factors should have prompted further investigation:

- CRA data showed Mr R had existing unsecured debt, mostly consisting of an overdraft and multiple credit cards, totaling £23,221, and Zopa estimated his monthly repayment towards this debt to be £1,161. Compared to his declared income of £32,000 (verified as £2,128 per month after tax), he appears to have been heavily indebted.

- CRA data also showed Mr R was nearly £4,500 overdrawn on his current account, suggesting he was living beyond his means.

- CRA data also showed Mr R took out a new credit card as recently as April 2023 (the month before his loan application) with a limit of £8,500 and had already built up a balance of over £6,600.

I believe this information suggests Mr R was already heavily indebted and further checks were required to complete a proportionate affordability assessment.

I can’t know exactly what further checks Zopa might have carried out at the time, but I think a consideration of Mr R’s actual income and expenditure would have been reasonable. So we’ve obtained copies of his bank statements for the three months prior to the lending to establish what information could reasonably have been discovered.

In view of Mr R’s relatively precarious situation as outlined above, I think it would also have been reasonable for Zopa to have checked what debts Mr R intended to repay so it could satisfy itself the loan would improve his overall position. As it didn’t ask for this information, we’ve asked Mr R how he used the money borrowed and he told us that around £10,000 was used to reduce existing overdraft and credit card debt, with most of the remainder used to repay money owed to family and to pay a tax bill.

Based on this information, the Zopa loan had the effect of reducing Mr R’s revolving credit commitments by £10,000. Using the approach Zopa applied in considering the application – that the monthly cost of these commitments equates to 5% of the outstanding balance – this would have reduced his monthly outgoings by £500 per month.

The effect of the loan was to increase Mr R’s unsecured debt by £5,000 and the loan repayment of £585 actually increased his monthly credit commitments by £85 per month (to £1,245). When this is added to his other essential expenditure, including mortgage, utilities and child maintenance payments evidenced in his bank statements, I share the investigator’s view that the monthly loan repayment wasn’t affordable from his income of £2,128, as verified with the CRA at the time.

If Zopa had seen this information, it’s my view that it shouldn’t have lent. Mr R was already failing to keep up with his regular commitments – as shown by the extent of his overdraft – and couldn’t afford additional repayments for the loan. I think an appropriate affordability assessment would have shown this.

In summary, if Zopa had adequately assessed whether the loan repayments were affordable and sustainable, it’s my view it shouldn’t have lent to Mr R. It’s for this reason that that I’m upholding his complaint.

Putting things right

The principal aim of any award I make must be to return Mr R to the position he’d now be in but for the errors or inappropriate actions of Zopa. But that’s not entirely possible here as the lending provided can’t be undone.

Because I don’t think Zopa should have lent to Mr R, I don’t think it’s fair for him to pay interest or charges on the amount borrowed. But he has had use of the money that was lent, so I think it’s fair he repays the amount borrowed (without the addition of interest or charges).

To put things right, Zopa now needs to take the following steps:

- Calculate the total of all Mr R’s payments towards the loan, including all interest, fees, charges and insurances (not already refunded).

- If this exceeds the £15,000 borrowed, any excess above £15,000 should be paid to him with simple interest at 8% per year from the date of each overpayment to the date of settlement.

HM Revenue & Customs (HMRC) requires Zopa to deduct tax from any interest. It must provide Mr R with a certificate showing how much tax has been deducted if he asks for one. If Zopa intends to apply the refund to reduce an outstanding balance, it must do so after deducting the tax.

- If the total of all Mr R's payments doesn't exceed the £15,000 borrowed, Zopa should arrange an affordable payment plan with him for the shortfall.

- Remove any adverse information recorded on Mr R's credit file relating to this loan, once any outstanding balance has been repaid.

If Zopa no longer owns the debt, it should liaise with whoever does to ensure any payments Mr R has made since moving the account are factored into the calculation of the compensation that's due or the balance that remains outstanding.

I'm satisfied this represents a fair and reasonable settlement to this complaint.

My final decision

For the reasons I've explained, I'm upholding Mr R's complaint. Subject to his acceptance, Zopa Bank Limited should now put things right as I've set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr R to accept or reject my decision before 19 June 2024.

James Biles
Ombudsman