

The complaint

Mr W is complaining about First Response Finance Ltd. He says they acted irresponsibly in lending to him because of his credit history and complains that this created an unfair relationship. Mr W's complaint has been brought to us by a representative but for ease I've written as if we've dealt directly with him.

What happened

In February 2019, Mr W took out a hire purchase agreement with First Response to finance the purchase of a vehicle. He paid a deposit of £700 and borrowed £4,299 – the cash price of the vehicle was £4,999. The agreement required Mr W to make 48 monthly repayments of £168.87. Although a couple of direct debits bounced, these didn't cause arrears because of Mr W's payment frequency – his direct debit was set up on a 4-weekly rather than a monthly cycle. Mr W didn't run into arrears until April 2021, when he stopped paying altogether and told First Response he couldn't afford to make repayments for a car that was undriveable.

First Response obtained a court judgment against Mr W in January 2022 and he settled the outstanding amount in full a few days later.

In September 2023, Mr W complained to First Response. He said they'd not taken reasonable steps to assess whether the agreement was affordable or suitable for him, this had caused him financial difficulty, and had meant the relationship between himself and First Response was unfair. Mr W also said he'd had to borrow funds from third parties to meet his commitments to First Response, and overall they'd had a significant adverse impact on his financial circumstances and mental health. Finally, Mr W said First Response hadn't treated him with forbearance and due consideration when he missed payments.

In response, First Response said a thorough affordability assessment is key to their business and that's what they'd done before lending to Mr W. They said this included a credit file search, detailed income and expenditure check, and income verification. They added that Mr W had had an excellent payment history up until he had issues with the vehicle performance and until that point he'd never given First Response any reason to believe there were any issues with his finances. So they didn't uphold Mr W's complaint and he brought it to our service.

One of our investigators looked into the matter and thought it should be upheld. He said although First Response had carried out reasonable and proportionate checks, they'd calculated that Mr W's disposable income would be around £95 per month. Our investigator didn't think this was enough to say the agreement was sustainably affordable. First Response disagreed – they said it didn't matter how much disposable income was left over in their income and expenditure assessment, the fact that there was some demonstrated that the agreement was affordable. On top of that they reiterated that Mr W had maintained his repayments without issue and hadn't provided any evidence that their lending decision had caused him any harm. Finally they noted that the vehicle was essential for Mr W. Because First Response disagreed with our investigator the complaint came to me for a decision. I issued a provisional decision on 16 May 2024. In that I said I thought the complaint should be upheld as follows:

"I've considered Mr W's statement that First Response's failure to establish that the hire purchase agreement was unsuitable resulted in the relationship being unfair. He

referred to the 2020 High Court judgment in the case of Kerrigan vs Elevate Credit International Limited (“Kerrigan”) where HHJ Worster confirmed a breach of creditworthiness assessment is a significant factor in making the relationship unfair.

I’ve considered the Kerrigan judgment and I’m inclined to agree with Mr W - paragraph 11 states: “Thus a failure by a creditor to undertake a proper creditworthiness assessment prior to entering into a regulated credit agreement would almost certainly affect the fairness of the relationship and so trigger the Court’s power to make appropriate orders under section 140B.” So I’ll first consider whether First Response carried out a proper creditworthiness assessment before deciding to lend to Mr W. I’ll then go on to think about what impact that had during the credit relationship, and whether the debtor-creditor relationship was unfair to Mr W.

Did First Response carry out a proper creditworthiness assessment?

The Financial Conduct Authority (FCA) sets out in a part of its handbook known as CONC what lenders must do when deciding whether or not to lend to a consumer. In summary, a firm must consider a customer’s ability to make repayments under the agreement without having to borrow further to meet repayments or default on other obligations, and without the repayments having a significant adverse impact on the customer’s financial situation. In effect this means considering whether a customer is likely to be able to meet their financial commitments (including the repayments under the proposed agreement) and their non-discretionary expenditure out of their income each month.

CONC says a firm must carry out checks which are proportionate to the individual circumstances of each case.

First Response said they carried out the following checks:

- reviewed Mr W’s credit file; and*
- checked Mr W’s payslips to verify his income;*
- spoke to Mr W to discuss his credit file and his housing costs;*
- carried out an income and expenditure assessment to assess his disposable income.*

They said Mr W had told them he was living with his parents and had one financial dependent. They added they’d used some general assumptions based on statistical data to estimate his cost of living expenses.

Whether or not these checks were proportionate depends on factors such as the size and term of the loan, the cost of credit, and what First Response found in the process of doing the checks. Mr W had to repay First Response over £8,000, over a four year period, with an Annual Percentage Rate (APR) of 41.9%. So the checks needed to be thorough.

First Response checked Mr W’s income, and they spoke to him to discuss his credit commitments and his housing costs – which are for most people the most significant monthly costs. They also obtained Mr W’s monthly credit payments from his credit file. And they used statistical data to estimate Mr M’s other expenditure. CONC allows firms to use statistical data unless they have reasonable cause to suspect that a customer’s non-discretionary expenditure is significantly higher than what’s shown in the data. I haven’t seen anything to suggest First Response shouldn’t have relied on statistical data, particularly as they used Mr W’s own estimates of his housing costs.

Taking all this together I'm satisfied First Response's checks were proportionate. They carried out a careful and substantiated analysis of Mr M's income and expenditure and obtained explanations for his previous credit history. I can't say they should have done anything further.

Did First Response make a fair lending decision?

First Response's analysis showed Mr W's income exceeded his non-discretionary and committed expenditure. Once the new agreement was taken into account, they expected Mr W would be left with a monthly surplus of around £95. I'm aware the disagreement between our investigator and First Response focuses on whether or not that amount is enough to say Mr W would be able to sustainably make the repayments under the agreement.

However, I've been through First Response's checks and their verification of Mr W's income concerns me. In calculating his average net monthly income, First Response divided the year-to-date pay according to his payslip by eight. But the payslip they were using for reference is dated 1 February 2019 and therefore reflects pay for ten months of the tax year. So the correct calculation would have been to divide his net year-to-date pay by ten. Doing so would reduce Mr W's net monthly pay from the £1,391.55 that First Response calculated to £1,027.61. First Response estimated Mr W's monthly expenditure at £1,217, so with a reduced income figure the agreement would have appeared to have been clearly unaffordable for Mr W.

It follows I don't think First Response made a fair lending decision.

Did First Response act unfairly in any other way?

Part of Mr W's complaint was that First Response hadn't acted with forbearance and due consideration when he fell into arrears. I can see that he missed a couple of payments. But because he was paying the monthly repayment amount every four weeks he didn't fall into arrears until April 2021 when he stopped making any payments.

First Response's contact notes suggest Mr W told them that he couldn't afford the payments because the car was undriveable so he'd had to reduce his work. First Response asked Mr W to complete an income and expenditure form and emailed this to him but didn't hear back from Mr W. I can see First Response attempted to contact Mr W by phone, text message, and email, and issued notices of default and of termination before eventually applying for a court judgment against Mr W.

I can't say First Response didn't treat Mr W with forbearance and due consideration – they tried to contact him for six months before starting legal proceedings.

I haven't seen anything else to suggest First Response acted unfairly in any other way.

What was the impact on Mr W?

First Response's position is that Mr W maintained his payments until the car became undriveable and so there's no evidence that the agreement caused him financial harm.

However, a review of Mr W's bank statements from March 2019 to January 2022 makes it clear that Mr W was using his overdraft almost all the time and was also borrowing from short term lenders and family members. This is consistent with Mr W's testimony. On top of this a review of Mr W's credit file shows that he defaulted on five other credit accounts within 15 months of taking out this agreement.

So I can't agree with First Response that the agreement didn't cause Mr W financial harm – instead I can see he was significantly impacted. The loan agreement proved to be unaffordable, which First Response ought reasonably to have foreseen at the time of lending. So I'm inclined to conclude that the lending decision First Response made created an unfair relationship as defined in section 140A of the Consumer Credit Act 1974.”

Both parties accepted my decision and had no further comments.

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.

Neither party has provided any comments which change my mind so my decision is unchanged from my initial thoughts and I'm upholding Mr W's complaint.

Putting things right

Fair compensation should aim to remedy the unfairness of Mr W and First Response's relationship arising out of First Response's failure to adequately assess the affordability of the agreement, but it shouldn't go further than it needs to or give Mr W a windfall.

Mr W asked for a refund of all sums paid to First Response, a refund of all interest, refund of the deposit paid, and payment of simple interest at an equivalent rate to that under the credit agreement. I've thought about these and about whether Mr W has lost out in any other way as a result of the agreement.

Mr W had use of the vehicle and kept it when he settled the agreement. I don't think it would be fair for him not to pay for the vehicle. But I don't think it's fair for First Response to receive interest or any charges under the agreement. So First Response should refund Mr W all amounts he's paid in excess of the cash price of £4,999 (including the deposit).

In addition, Mr W's had to borrow from elsewhere to make the repayments to First Response. Mr W's said First Response should compensate him for the interest he's had to pay to other lenders which he wouldn't otherwise have had to pay and suggested that the appropriate rate to use to calculate this would be the rate he paid to First Response, i.e. 41.9% APR.

I've considered this carefully. The interest rate Mr W was paying on the overdraft averaged around 50% per year across the period for which he was making repayments to First Response. However, Mr W's overdraft balance didn't continue to grow as the loan went on – instead it hovered around £500 - only the amount of three monthly instalments on the loan so the interest didn't continue to accumulate. In addition, Mr W defaulted on other credit agreements in order to make the payments under this agreement. This had the impact of reducing his immediate interest costs, although it would likely have increased his credit risk. He also borrowed from other lenders over short timeframes, but I haven't seen evidence of the rates at which he was borrowing and the short timeframes mean the interest costs were likely to be limited. Taking everything together, it's difficult to estimate the overall refinancing costs Mr W incurred in relation to the car loan but I'm satisfied the statutory interest rate of 8% is enough to compensate Mr W. I set this out in my provisional decision and Mr W didn't disagree.

In summary then, First Response should:

- Refund all the payments Mr W has made (including the deposit) in excess of £4,999, being the cash price of the vehicle, adding 8% simple interest per year* from the date

of each overpayment to the date of settlement.

- To the extent possible, remove any adverse information recorded on Mr W's credit file in relation to the agreement.

*If First Response consider tax should be deducted from the interest element of my award they should provide Mr W a certificate showing how much they've taken off so that Mr W can reclaim that amount, assuming he is eligible to do so.

My final decision

I'm upholding Mr W's complaint. First Response Finance Ltd need to take the steps outlined above to settle the matter.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr W to accept or reject my decision before 1 July 2024.

Clare King
Ombudsman