complaint

Miss A has complained to Tesco Personal Finance PLC (Tesco) about the sale of three single premium payment protection insurance (PPI) policies. These policies were sold in conjunction with personal loans between March 2004 and October 2006. Tesco has upheld Miss A's complaint and offered her redress.

Miss A is unhappy as Tesco has indicated that it will use the redress to reduce arrears on a fourth loan that Miss A took out in April 2007 without PPI.

background

Between March 2004 and October 2006 Miss A took out the following loans which were sold to her with single premium PPI policies attached:

Loan #1 March 2004.

Loan #2 February 2006. This loan was used partly to refinance Loan #1 and part of the PPI premium from Loan #1 was carried forward into this loan.

Loan #3 October 2006. This loan was used partly to refinance Loan #2 and part of the PPI premium from Loan #2 was carried forward into this loan.

In April 2007 Miss A took out Loan #4 which all parties agree was sold without a PPI policy.

Miss A complained to Tesco about the sale of the PPI policies in June 2011.

In November 2011 Tesco responded to Miss A's complaint. In its letter Tesco confirmed that it was willing to uphold Miss A's complaint and pay her the appropriate redress. Tesco's letter went on to set out how it had calculated the redress due to Miss A, but it also said that it would be using all the redress to reduce the outstanding arrears Miss A had on Loan #4.

Unhappy with Tesco's proposed approach Miss A brought her complaint to this service. Miss A said that Loan #4 had nothing to do with her first three loans which had all been cleared. Therefore Miss A considers that Tesco should pay all the redress directly to her.

In August 2013 an adjudicator from this service wrote to Tesco. In her letter the adjudicator recommended that Miss A's complaint should be upheld and that Tesco should pay the redress directly to Miss A.

The adjudicator explained that although each successive loan was used partly to clear the previous loan, she was of the opinion that each should be considered as a separate loan account. The adjudicator went on to say that this service would consider it fair and reasonable for Tesco to use the redress from a mis-sold PPI policy to reduce arrears on the associated loan account – if there were any. However, Tesco was proposing to use the redress from PPI sold with loans #1, #2 and #3 to offset against arrears on Loan #4 which is a separate account, and the adjudicator didn't consider that to be a reasonable approach.

Tesco did not agree with the adjudicator's findings and has asked that an ombudsman consider the complaint. Tesco has argued that it has a "right of set off" which it says means that it can use the PPI redress payable to Miss A to reduce the outstanding arrears on Loan #4.

In its response to the adjudicator, Tesco has said:

"It is correct that guidance from the Lending Standards Board and FSA require that where a firm intends to exercise the right of set-off, a key consideration is to ensure the customer is left with sufficient funds for essential day to day living expenses and any priority debts. As the PPI redress does not form part of an account balance from which the customer would normally meet these expenses, we think it is reasonable to firstly apply the redress against their outstanding debt with us unless the customer can provide evidence of an IVA or bankruptcy."

my findings

I have considered all the available evidence and arguments to decide what is fair and reasonable in the circumstances of this complaint.

As Tesco has already agreed to uphold Miss A's complaint about the sale of the PPI policies I propose to limit myself to the question of whether it is fair and reasonable for Tesco to apply any of the redress payable to Miss A in respect of the sale of the three PPI policies sold in association with loans #1, #2 and #3 to reduce the arrears balance on loan #4.

In its response to the adjudicator's letter Tesco has assumed it has a right to set-off the redress payable for the mis-sold PPI against Miss A's outstanding arrears. Tesco has said it can exercise this right providing it has taken into account factors such as whether Miss A has other priority debts. However I have firstly considered whether it is fair and reasonable for Tesco to apply the right of set-off *at all* in this instance, irrespective of Miss A's circumstances.

Tesco says it has a right of set off, which it says means that it can use the PPI compensation payable to Miss A to reduce her outstanding debt. It says that this approach is consistent with the general law which recognises the equitable right of one party to set off amounts owed where the other party is in debt to it.

When I decide what is fair and reasonable in each case, I must take into account (though I am not necessarily bound by), amongst other things, the relevant law as well as any relevant regulatory rules.

The Financial Conduct Authority has issued guidance for financial businesses handling PPI complaints.

That guidance states:

"Where the complainant's loan or credit card is in arrears the firm may, if it has the contractual right to do so, make a payment to reduce the associated loan or credit card balance, if the complainant accepts the firm's offer of redress. The firm should act fairly and reasonably in deciding whether to make such a payment" (DISP Appendix 3.9.1 G).

A strict reading of the relevant guidance suggests that Tesco can only use PPI compensation to reduce arrears on the *associated* loan or credit card balance and only where *it has the contractual right to do so*.

Here, the first three loans taken out by Miss A (the associated loans) have been settled by (Tesco's) refinancing of them, so there are no arrears on those loans. So, setting aside whether or not Tesco has a *contractual right*, applying the relevant guidance suggests that Tesco is *not* entitled to use the compensation for the mis-sale of PPI alongside Miss A's first three loans to reduce the outstanding balance on her fourth and final loan as it is not the *associated loan* in this case.

The equitable right of set off in law allows a person to 'set off' *closely connected debts*. This means that one person (X) can deduct from a debt that they owe another person (Y), money which that person (Y) owes to them.

In order for the equitable right of set off to apply, I must be satisfied there is a close connection between the PPI compensation due to be paid and the outstanding debt against which Tesco proposes to set it off. If the first test is 'passed', I must then also consider whether it would be unjust not to allow Tesco to set off in this way. Both tests need to be satisfied in order for me to conclude that Tesco may have an equitable right to set off the PPI compensation against Miss A's indebtedness to it.

In relation to the first limb of the test, I am not persuaded there is a close connection between the *redress* payable in respect of the PPI policies taken out in connection with Miss A's first three loans and the *arrears* on the fourth and final loan, and this is why:

I accept that it may well often be reasonable for redress payable in respect of the mis-sale of a PPI policy to be set-off against the loan with which the sale of the PPI was associated. That basic principle is consistent with the FCA guidance referred to above.

But it is another matter to say that a debt owed by Miss A on a *later* loan (a loan which refinanced a loan with which one of the PPI policies was sold) is necessarily to be regarded as *closely* connected with the *debt* owed by Tesco arising from the earlier mis-sale of PPI policies (e.g. the requirement on Tesco to pay compensation).

That 'debt' owed by Tesco to Miss A – the PPI compensation – arises as a result of the mis-sale of policies connected to the sale of the loans taken out at that time. The debt Miss A owed to Tesco in connection with those loans was extinguished at the point her loans were refinanced – and replaced with a separate contractual arrangement setting out new terms for repayment of her borrowing.

While it may be the case that Miss A's loan had monies outstanding to be repaid under that agreement at the point at which she refinanced, those monies were, in effect, repaid by her new borrowing under her new agreement. So Miss A's debt under her first loan was extinguished and replaced with a new liability under her new loan – the same occurring each time Miss A refinanced.

At each juncture Miss A's earlier borrowing was repaid under new finance agreements on terms acceptable to both Tesco and Miss A. Put simply, the earlier loan agreements have been repaid and there are no arrears under those agreements, or indeed any continuing contractual obligations.

The loans and PPI policies are connected from the point of view of calculating any redress due to Miss A for the mis-sale of PPI because the cumulative effect on Miss A's position (compared to where she would have been if she hadn't been sold PPI) is carried forward into higher borrowing than would otherwise be the case.

But is it not true to say that Miss A's debt owed to Tesco was carried forward in the same way – as set out above, Miss A's debt was crystallised and repaid on each occasion Tesco agreed to refinance her borrowing.

Put another way, one 'debt' (that owed by Tesco to Miss A) arises from the consequences of shortcomings in the sale of a specific product, at a specific time, in connection with a loan which has since been repaid. The other debt (that currently owed by Miss A to Tesco under the terms of her current loan) is a reflection of contractual obligations formed at an entirely different time.

So, it may be the case that the successive *loans* in Miss A's case have some connection insofar as they form a chain of refinance, which is relevant for the purpose of calculating redress and putting Miss A back in the position she otherwise would have been in. But it does not seem to me that compensation for the mis-sale of PPI connected to earlier loans which have since been repaid by Miss A (whether by refinancing or other means), and the existing debt owed by Miss A under her fourth loan, are *closely* connected so as would make it fair and reasonable for the one to be set-off against the other.

summary

For the reasons given above I am satisfied that the existing debt owed by Miss A under her fourth loan is a separate account and not closely connected to the three previous loans which have been repaid.

It follows that I do not consider it fair and reasonable for Tesco to set-off the redress from the PPI policies sold with Miss A's first three loans against the arrears on Miss A's fourth loan.

my final decision

My final decision is that I uphold Miss A's complaint. I order Tesco Personal Finance PLC to recalculate its offer up to the date of settlement and pay the redress directly to Miss A.

Steve Thomas
ombudsman