Financial Ombudsman Service

complaint

This complaint concerns the redress related to four premium payment protection insurance policies (PPI) sold in association with loans from Tesco Personal Finance PLC ("Tesco").

Tesco has upheld Miss J's complaint and offered her redress. But Tesco wants to use the redress due for all of the policies against an outstanding debt on the last loan Miss J took out in 2005. Miss J is unhappy with this and wants the redress paid directly to her.

background

Miss J took out four loans with Tesco between 2003 and 2005. On each occasion Miss J also purchased PPI. The loans were a series of successive loans each, until the fourth and last in 2005, being settled and consolidated into the next loan. Miss J went into arrears on the last loan and a debt remains outstanding on this loan.

Miss J complained to Tesco about the sale of the PPI with her loans and Tesco wrote to her in July 2012 saying it upheld her complaints and offered a full refund of the costs paid for the PPI. However it went on to say that as the last loan was in arrears it would apply the whole of the refund for all the policies against those arrears.

Miss J was unhappy with Tesco's approach and brought her complaint to this service. Miss J did not feel Tesco's approach would put her in the position she would have been in had she not taken out the PPI with the loans She felt Tesco should pay all the redress directly to her as she would have had this money to use for other payments had the PPI not been bought.

In 2013 an adjudicator indicated to Tesco that its proposal to use the redress due for the first three loans to pay arrears on the last loan would not be fair as these loans were settled in full and there were no arrears on these accounts.

In respect of the fourth and last loan the adjudicator felt it would be fair and reasonable to use the refund of redress for the PPI purchased with this loan to reduce the arrears on this loan only.

Tesco did not agree and requested an ombudsman consider the complaint.

my findings

I have briefly outlined above the background but I have considered all the available evidence and arguments to decide what is fair and reasonable in the circumstances.

As Tesco has agreed to uphold Miss J's complaint about the sale of the PPI policies I will not address the issue of how the PPI policy came to be sold to Miss J. I will only address the issues relating to the redress payable and how this should be refunded to Miss J.

The main focus of Miss J's complaint is that she considers all the compensation should be paid directly to her and not used to reduce the debt on the final loan account she had with Tesco.

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 J's outstanding arrears. Tesco has said it can exercise this right providing it has taken into account factors such as whether Miss J 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 J'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 J 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, amongst other things, the relevant law as well as any relevant regulatory rules, although I am not necessarily bound by them.

The Financial Conduct Authority (FCA) (previously the Financial Services Authority (FSA)) 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 reasonable in deciding whether to make such a payment". (DISP App 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 and only where *it has the contractual right to do so.*

In this complaint the first three loans taken out by Miss J which had PPI attached to them (the associated loan) have been settled by refinancing them with Tesco, so there are no arrears on these 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 the PPI sold alongside Miss J's first three loans to reduce the outstanding balance on her fourth and final loan as this 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.

Tesco is also raising this wider, equitable right of set off. For this to apply, I must be satisfied that there is a close connection between the PPI compensation and the outstanding debt which Tesco would like the compensation set against. *If* this first hurdle is met I must also consider whether it would be unjust not to allow Tesco to set off in this way. *Both* tests must be satisfied for me to conclude Tesco has an equitable right to set-off the PPI compensation against Miss J's outstanding arrears.

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 J's first three loans and the *arrears* on the fourth and final loan.

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 J 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 J – the PPI compensation – arises as a result of the mis-sale of policies connected to the sale of the loan taken out at that time. The debt Miss J owed to Tesco in connection with the loan was extinguished at the point her loan 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 J's loans 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 J's debt under her first loan was extinguished and replaced with a new liability under her new loan – the same occurring each time Miss J refinanced.

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

The debt owed by Tesco to Miss J 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 J to Tesco under the terms of her current loan, is a reflection of contractual obligations formed at an entirely different time.

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 J, and the existing debt owed by Miss J 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.

It does however logically follows from the above factors that the PPI on the fourth and final loan *is* closely connected with that loan as it was taken out at the same time as the loan. So it also follows it is fair and reasonable for Tesco to set off any redress due for the PPI purchased in connection with this fourth loan against the actual loan with which it is associated.

I have also noted Tesco's comment in response to the adjudicators view regarding the consideration of priority debts and that in their view this would not apply in Miss J's circumstances so set-off should be permitted. This is the second part of the test I referred to earlier.

However as the first part of the test showing a *close connection* between the PPI compensation and the outstanding debt has not in my view been met I do not need to consider the circumstances of priority debts.

I have also noted Tesco's comment in response to the adjudicators view regarding the consideration of priority debts and that in their view this would not apply in Miss J's circumstances so set-off should be permitted. This is the second part of the test I referred to earlier.

As the first part of the test showing a *close connection* between the PPI compensation and the outstanding debt has not in my view been met with regard to the first three loans I do not need to consider the circumstances of priority debts in relation to this.

The fourth loan and the compensation for the PPI sold with that does meet the first part of the test, being closely associated, so I do need to consider whether it would be unjust for Tesco to use the PPI redress as set off against the debt Miss J owes them if Miss J has more pressing priority debts.

Miss J has been requested to provide evidence of priority debts for consideration in relation to this. She has provided copies of some utility bills but I have seen no substantive evidence that there are any priority debts (e.g. rent, utility bills etc) that are outstanding and would take priority over the debt Miss J owes to Tesco in relation to her fourth loan.

summary

In summary I am not persuaded that there is a close association between the debt arising from Miss J's arrears on her fourth and last loan and the debt Tesco owes to her as redress for the mis-sale of the three PPI policies sold in connection with the first three loans. So it follows I am of the view it is fair and reasonable that the redress for the sale of the PPI for these loans should be paid directly to Miss J.

I am also of the view that the PPI sold in connection with the fourth and final loan in 2005 does have a close connection. Having seen no substantive evidence of priority debts outstanding I am of the view that Tesco should be permitted to set off its debt to Miss J against the arrears on the debt she owes them from her fourth loan.

As Miss J did not accept the offer from Tesco it is my understanding the redress has not as yet been paid to her. In these circumstances Tesco must recalculate the interest at 8% per year simple† to bring this up to date to the date of settlement on all of the loans.

† I understand Tesco is required to deduct basic rate tax from this part of the compensation. Whether Miss J needs to take any further action will depend on her financial circumstances. More information about the tax position can be found on our website.

Miss J should refer back to Tesco if she is unsure of the approach it has taken and both parties should contact HM Revenue & Customs if they want to know more about the tax treatment of this portion of the compensation.

my final decision

For the reasons set out above I uphold this complaint and direct that Tesco Personal Finance PLC should pay the redress related to the first three loans directly to Miss J.

I also direct that Tesco Personal Finance PLC should be allowed to set off the compensation due for the PPI related to the fourth and final loan against the debt outstanding related to that loan.

I make no other award against Tesco Personal Finance PLC.

Christine Fraser
ombudsman