

complaint

Mr B and Miss V have complained that UK Credit Limited ("UK Credit") irresponsibly provided Mr B with an unaffordable guarantor loan.

They say that Mr B shouldn't have been given the loan as he was already in the midst of increasing debt, bank charges, payday loans, late payments, defaults and a debt management plan due to an extreme gambling habit.

background

UK Credit provided Mr B with a guarantor loan in November 2017. The loan was for £8,000 and it was due to be repaid in 60 instalments of £279.08. The total amount to be repaid was £16,744.40.

One of our adjudicator's reviewed Mr B's complaint. She told UK Credit that the checks it carried out before providing Mr B with this loan weren't reasonable and proportionate and if such checks had been carried out it would have seen that Mr B wasn't in a position to sustainably make the repayments.

So she thought that UK Credit shouldn't have provided Mr B with this loan and upheld the complaint. UK Credit disagreed with our adjudicator's assessment and asked for an ombudsman's decision. So the complaint has now been passed to me for a final decision.

the regulatory framework

UK Credit provided Mr B with this loan when it was authorised by the Financial Conduct Authority. This meant that it was subject to the FCA rules and regulations.

- *the FCA Principles for Business ("PRIN")*

The FCA's Principles for Business set out the overarching requirements which all authorised firms are required to comply with.

PRIN 1.1.1G, says

The Principles apply in whole or in part to every firm.

The Principles themselves are set out in PRIN 2.1.1R. And the most relevant principle here is PRIN 2.1.1 R (6) which says:

A firm must pay due regard to the interests of its customers and treat them fairly.

- *the Consumer Credit sourcebook ("CONC")*

This sets out the rules and guidance which apply to guarantor loan providers like UK Credit when providing loans. CONC 5 sets out a firm's obligations in relation to responsible lending.

It's clear there is a high degree of alignment between the OFT's *Irresponsible Lending Guidance* ("ILG") and the rules set out in CONC 5. As is evident from the following extracts, the FCA's CONC rules specifically note and refer back to sections of the OFT's ILG on many occasions.

Section 5.2.1R(2) of CONC sets out what a lender needs to do before agreeing to give a borrower a loan. It says a firm must consider:

- (a) the potential for the commitments under the regulated credit agreement to adversely impact the customer's financial situation, taking into account the information of which the firm is aware at the time the regulated credit agreement is to be made; and*

[Note: paragraph 4.1 of ILG]

- (b) the ability of the customer to make repayments as they fall due over the life of the regulated credit agreement, or for such an agreement which is an open-end agreement, to make repayments within a reasonable period.*

[Note: paragraph 4.3 of ILG]

CONC also includes guidance about 'proportionality of assessments'. CONC 5.2.4G(2) says:

A firm should consider what is appropriate in any particular circumstances dependent on, for example, the type and amount of credit being sought and the potential risks to the customer. The risk of credit not being sustainable directly relates to the amount of credit granted and the total charge for credit relative to the customer's financial situation.

[Note: paragraph 4.11 and part of 4.16 of ILG]

CONC 5.3 contains further guidance on what a lender should bear in mind when thinking about affordability.

CONC 5.3.1G(1) says:

In making the creditworthiness assessment or the assessment required by CONC 5.2.2R (1), a firm should take into account more than assessing the customer's ability to repay the credit.

[Note: paragraph 4.2 of ILG]

CONC 5.3.1G(2) then says:

The creditworthiness assessment and the assessment required by CONC 5.2.2R (1) should include the firm taking reasonable steps to assess the customer's ability to meet repayments under a regulated credit agreement in a sustainable manner without the customer incurring financial difficulties or experiencing significant adverse consequences.

[Note: paragraph 4.1 (box) and 4.2 of ILG]

CONC 5.3.1G(6) goes on to say:

For the purposes of CONC "sustainable" means the repayments under the regulated credit agreement can be made by the customer:

- (a) *without undue difficulties, in particular:*
 - (i) *the customer should be able to make repayments on time, while meeting other reasonable commitments; and*
 - (ii) *without having to borrow to meet the repayments;*
- (b) *over the life of the agreement, or for such an agreement which is an open-end agreement, within a reasonable period; and*
- (c) *out of income and savings without having to realise security or assets; and*

“unsustainable” has the opposite meaning.

[Note: paragraph 4.3 and 4.4 of ILG]

In respect of the need to double-check information disclosed by applicants, CONC 5.3.1G(4) has a reference to paragraphs 4.13, 4.14, and 4.15 of ILG and states:

- (a) *it is not generally sufficient for a firm to rely solely for its assessment of the customer's income and expenditure on a statement of those matters made by the customer.*

And CONC 5.3.7R says that:

A firm must not accept an application for credit under a regulated credit agreement where the firm knows or ought reasonably to suspect that the customer has not been truthful in completing the application in relation to information supplied by the customer relevant to the creditworthiness assessment or the assessment required by CONC 5.2.2R (1).

[Note: paragraph 4.31 of ILG]

CONC also contains the additional obligations owed by guarantor loan providers to guarantors when providing a guarantor loan. The additional requirements in relation to an assessment of the guarantor's circumstances are contained in CONC 5.2.5R.

As the guarantor isn't a party to this complaint, I don't think that it's necessary to set out all the rules and guidance relating to the additional obligations owed to guarantor in this decision. That said I do think it's useful for me to set out CONC 5.2.6G which says:

- (2) *The provision of the guarantee or indemnity (or both), and the assessment of the guarantor under CONC 5.2.5R, does not remove or reduce the obligation on the lender to carry out an assessment of the borrower under CONC 5.2.1R or CONC 5.2.2R. Firms are reminded of the rule in CONC 5.3.4R that the assessment of the borrower must not be based primarily or solely on the value of any security provided by the borrower.*

Section 140 of the Consumer Credit Act 1974

Mr B's loan was provided after Section 140 of the Consumer Credit Act came into force on 6 April 2007. Section 140A sets out circumstances where the court may determine that the relationship between a creditor and a debtor is unfair to the debtor.

Section 140A says:

140A Unfair relationships between creditors and debtors

- (1) The court may make an order under section 140B in connection with a credit agreement if it determines that the relationship between the creditor and the debtor arising out of the agreement (or the agreement taken with any related agreement) is unfair to the debtor because of one or more of the following-*
 - (a) any of the terms of the agreement or of any related agreement;*
 - (b) the way in which the creditor has exercised or enforced any of his rights under the agreement or any related agreement;*
 - (c) any other thing done (or not done) by, or on behalf of, the creditor (either before or after the making of the agreement or any related agreement).*
- (2) In deciding whether to make a determination under this section the court shall have regard to all matters it thinks relevant (including matters relating to the creditor and matters relating to the debtor).*
- (3) For the purposes of this section the court shall (except to the extent that it is not appropriate to do so) treat anything done (or not done) by, or on behalf of, or in relation to, an associate or a former associate of the creditor as if done (or not done) by, or on behalf of, or in relation to, the creditor.*
- (4) A determination may be made under this section in relation to a relationship notwithstanding that the relationship may have ended.*
- (5) An order under section 140B shall not be made in connection with a credit agreement which is an exempt agreement [for the purposes of Chapter 14A of Part 2 of the Regulated Activities Order by virtue of article 60C(2) of that Order (regulated mortgage contracts and regulated home purchase plans)]*

Section 140B sets out the types of order the court could make should it determine that the relationship between the creditor and debtor is unfair to the debtor. Section 140B says:

140B Powers of court in relation to unfair relationships

- (1) An order under this section in connection with a credit agreement may do one or more of the following—*
 - (a) require the creditor, or any associate or former associate of his, to repay (in whole or in part) any sum paid by the debtor or by a surety by virtue of the agreement or any related agreement (whether paid to the creditor, the associate or the former associate or to any other person);]*

- (b) require the creditor, or any associate or former associate of his, to do or not to do (or to cease doing) anything specified in the order in connection with the agreement or any related agreement;*
- (c) reduce or discharge any sum payable by the debtor or by a surety by virtue of the agreement or any related agreement;*
- (d) direct the return to a surety of any property provided by him for the purposes of a security;*
- (e) otherwise set aside (in whole or in part) any duty imposed on the debtor or on a surety by virtue of the agreement or any related agreement;*
- (f) alter the terms of the agreement or of any related agreement;*
- (g) direct accounts to be taken, or (in Scotland) an accounting to be made, between any persons.*

other relevant publications

CONC set out the regulatory framework that authorised lenders have to adhere to. But the rules and guidance represent a minimum standard for firms. And I'm also required to take into account any other guidance, standards, relevant codes of practice, and, where appropriate, what I consider to have been good industry practice.

the FCA's Portfolio Strategy Letter to firms providing high cost lending products

On 6 March 2019, The FCA wrote a 'Dear CEO' letter to the Chief Executive Officer of all the firms it allocated to its 'High Cost Lenders' portfolio. The letter set out the FCA's view of the key risks that High Cost Lenders pose to consumers and the markets they operate in. On page two of this letter, the FCA sets out its view of the key causes of harm. It says:

"To assess how firms in the High Cost Lenders portfolio could cause harm, we analysed their strategies and business models. We considered a wide range of information and data, including firms' regulatory histories, the number and nature of complaints, and findings from the HCCR. We also carried out diagnostic work on guarantor lenders, which involved issuing a data request to firms in October 2018.

Following our analysis, we see two key ways that consumers may be harmed across the High Cost Lenders portfolio:

- a high volume of relending, which may be symptomatic of unsustainable lending patterns*
- firms' affordability checks may be insufficient, leading to loans that customers may not be able to afford".*

We also see an additional potential harm from guarantor lending:

- *the proportion of loan repayments that guarantors make has risen considerably, which could indicate that affordability on the part of the borrowers is falling*

On page three of the letter, in the section entitled '**Complaints**' it says:

"We expect firms to fulfil all relevant obligations, including analysing the root causes of complaints and taking into account the Financial Ombudsman Service's relevant decisions. We gave further detail about what we expect from firms' complaint-handling procedures in the Dear CEO letter we issued to HCSTC firms in October 2018. This is equally relevant to all firms in the portfolio".

Further detail in relation to the FCA's future work was provided on page four of the letter. The section entitled '**Additional focus for firms providing guarantor lending**' said:

As well as the areas of focus above, we will also prioritise our supervisory work with firms that provide guarantor loans in the following area:

Payments made by guarantor:

Our diagnostic work on guarantor lending showed that many guarantors make at least one repayment and the proportion of guarantors making payments is growing. We want to understand the root causes for this increase, and whether firms are conducting adequate affordability assessments. We are also concerned that guarantors may not fully understand how likely it is that they will be called upon to make a payment. So, as well as our broad portfolio-wide work on relending, we will start a piece of complementary work on guarantor lending. This will establish whether potential guarantors have enough information to understand the likelihood and implications of the guarantee being enforced.

the FCA's Dear CEO letter on affordability of High-Cost Short-Term Credit ("HCSTC") loans

On 15 October 2018, the FCA wrote a 'Dear CEO' letter to the Chief Executive Officer of all HCSTC providers. The letter was about the issues surrounding the increase in complaints about unaffordable lending.

The third paragraph of this letter said:

"We note that the Ombudsman has recently published four examples of determinations of individual complaints about payday loans to illustrate its approach to the issues raised in those complaints (see: <https://www.financial-ombudsman.org.uk/publications/technical.htm>). If relevant, firms should take these examples of determinations into account as part of establishing their own effective procedures for complaints handling (see DISP 1.3.1R)".

Paragraph eight of the letter went on to say:

"We would highlight in particular the risks in relation to repeat borrowing. These were flagged in our price cap proposals in CP14/10, in July 2014, in which we said that we were concerned that repeat borrowing could indicate a pattern of dependency on HCSTC that is harmful to the borrower. We noted that rigorous affordability assessments were key to avoiding harm in this area, and firms should ensure they are making responsible assessments of the sustainability of borrowing".

the FCA Executive Director of Supervision's (Retail and Authorisations) speech at the Credit Summit, London, on 21 March 2019

The FCA's Executive Director of Supervision gave a speech at the Credit Summit, which took place on 21 March 2019, entitled "What can the consumer credit sector expect from the FCA?".

The speech reiterated much of what was said in the High Cost Credit portfolio strategy letter (set out above) issued on 6 March 2019. And in his speech the Executive Director of Supervision said:

"Over the last few years we have seen a dramatic increase in the use of guarantor loans by consumers. Balances on guarantor loans are fast approaching £1 billion and these have more than doubled since 2016.

While these products provide an opportunity for those with thin credit files - poor or limited credit history - we do have concerns. Concerns about affordability. Recent work we have done in this area showed that many guarantors are making at least 1 payment and the proportion of guarantors making these payments is growing.

There is also growing anecdotal evidence that guarantors may not understand how likely it is that they will be called upon to make a payment. Our work will therefore focus on affordability and on understanding whether potential guarantors have enough information to understand the likelihood and implications of the guarantee being enforced.

We have already amended certain rules to ensure that the protections they provide to borrowers also extend to guarantors, for example rules requiring forbearance, pre-contractual explanations and fair treatment. In assessing creditworthiness, we have clarified that firms must undertake a reasonable assessment of the potential for the guarantor's commitment to have a significant adverse impact on their financial situation.

And if the guarantor is called upon, we have published guidance on our view of what constitutes 'enforcement' of the guarantee under the CCA – in practice this means we expect firms to provide guarantors with adequate notice before exercising a Continuous Payment Authority (CPA).

There are also questions over the level of interest rates charged on these products considering that these guarantors are deemed to be credit worthy, we will therefore be considering this and the business models of these firms".

my findings

I have read and considered all the evidence and arguments available to me from the outset, in order to decide what is, in my opinion, fair and reasonable in all the circumstances of the case.

Taking into account the relevant rules, guidance, good industry practice and law, I think there are two overarching questions I need to consider in order to decide what's fair and reasonable in the circumstances of this particular complaint.

These two overarching questions are:

- Did UK Credit complete reasonable and proportionate checks to satisfy itself that Mr B would be able to repay his loan in a sustainable way?
 - If so, did it make a fair lending decision?
 - If not, would those checks have shown that Mr B would've been able to do so?
- Did UK Credit act unfairly or unreasonably in some other way?

If I determine that UK Credit didn't act fairly and reasonably in its dealings with Mr B and that he has lost out as a result, I will go on to consider what is fair compensation.

Did UK Credit complete reasonable and proportionate checks to satisfy itself that Mr B would be able to repay his loan in a sustainable way?

The rules and regulations at the time UK Credit lent to Mr B required it to carry out a reasonable and proportionate assessment of whether he could afford to repay his loan in a sustainable manner. UK Credit was required to carry out this borrower focused assessment in addition to a similar one on the guarantor. This assessment is sometimes referred to as an "affordability assessment" or "affordability check".

The checks had to be "borrower" focused – so UK Credit had to think about whether repaying the loan sustainably would cause difficulties or adverse consequences *for Mr B*. In practice this meant that UK Credit had to ensure that making the payments to the loan wouldn't cause Mr B undue difficulty or adverse consequences.

In other words, it wasn't enough for UK Credit to simply think about the likelihood of it getting its money back, it had to consider the impact of loan repayments on Mr B. The existence of a guarantee and the potential for UK Credit to pursue the guarantor instead of Mr B, for the loan payments doesn't alter, lessen, or somehow dilute this obligation.

Checks also had to be "proportionate" to the specific circumstances of the loan application. In general, what constitutes a proportionate affordability check will be dependent upon a number of factors including – but not limited to – the particular circumstances of the consumer (e.g. their financial history, current situation and outlook, and any indications of vulnerability or financial difficulty) and the amount / type / cost of credit they are seeking. Even for the same customer, a proportionate check could look different for different applications.

In light of this, I think that a reasonable and proportionate check ought generally to have been *more* thorough:

- the *lower* a customer's income (reflecting that it could be more difficult to make any loan repayments to a given loan amount from a lower level of income);
- the *higher* the amount due to be repaid (reflecting that it could be more difficult to meet a higher repayment from a particular level of income);
- the *longer* the term of the loan (reflecting the fact that the total cost of the credit is likely to be greater and the customer is required to make payments for an extended period); and

- the *greater* the number and frequency of loans, and the longer the period of time during which a customer has been given loans (reflecting the risk that repeated refinancing may signal that the borrowing had become, or was becoming, unsustainable).

There may also be other factors which could influence how detailed a proportionate check should've been for a given loan application – including (but not limited to) any indications of borrower vulnerability and any foreseeable changes in future circumstances.

I've carefully thought about all of the relevant factors in this case.

Were UK Credit's checks reasonable and proportionate?

UK Credit has said that it completed a detailed income and expenditure assessment with Mr B during what it has called a 'security' call. During this call Mr B confirmed that he was self-employed and had average earnings of £1,377 after tax. Mr B was asked to evidence this and provided his business account statements for the previous four months, which confirmed this was the case.

It has also said Mr B confirmed the details of his monthly expenditure and this together with the income information obtained and credit check carried out all suggested that Mr B would comfortably be able to make the repayments to this loan.

I've carefully thought about what UK Credit has said. But simply requesting information from a borrower doesn't, on its own, mean that a lender will have carried out a borrower focused assessment of the borrower's ability to sustainably repay a loan.

I say this while especially mindful of the fact that the rules themselves provide guidance on the proportionality of affordability/creditworthiness assessments. The rules and guidance suggest that the risk of any credit not being sustainable directly relates to the amount of credit granted and the total charge for credit relative to the customer's financial situation.

The credit check UK Credit carried out and the content of the call it had with Mr B indicated that Mr B already had a guarantor loan with another provider and he'd taken a significant amount of payday loans previously.

I know that UK Credit says it received what it considered to be a plausible explanation from Mr B about his existing debts. However, in my view, bearing in mind the term of the loan, the cost of the credit, what UK Credit had seen or ought to have seen in the information gathered and the potential implications for the guarantor, UK Credit needed to get a thorough understanding of Mr B's financial position in order to properly assess whether he'd be able to sustainably make the loan payments he was being asked to commit to.

So as well as asking Mr B about the details of his income and expenditure, I think that UK Credit needed to verify what it was being told by Mr B, rather than relying on what Mr B declared for his monthly expenditure. It could have done this by asking for information such as bank statements (for his personal account which his business account statements clearly show his salary was being transferred to) or copies of bills. And when it obtained this information it needed to properly scrutinise it and ensure that Mr B did have enough funds to be able to make the payments.

As there's no evidence that UK Credit did properly scrutinise the information provided, or that it asked Mr B to provide documentary evidence to support the expenditure declarations made, I find that it didn't complete fair, reasonable and proportionate affordability checks before providing Mr B with this loan.

Would reasonable and proportionate checks have indicated to UK Credit that Mr B would have been unable to sustainably repay this loan?

As reasonable and proportionate checks weren't carried out before this loan was provided, I can't say for sure what they would've shown. So I need to decide whether it is more likely than not that a proportionate check would have told UK Credit that Mr B would've been unable to sustainably repay this loan.

Mr B has now provided us with evidence of his financial circumstances at the time he applied for this loan. Of course, I accept different checks might show different things. And just because something shows up in the information Mr B has provided, it doesn't mean it would've shown up in any checks UK Credit might've carried out.

But in the absence of anything else from UK Credit showing what this information would have shown, I think it's perfectly fair, reasonable and proportionate to place considerable weight on it as an indication of what Mr B's financial circumstances were more likely than not to have been at the time.

As I've already explained, UK Credit was required to establish whether Mr B could sustainably make his loan repayments – not just whether the loan payments were technically affordable on a strict pounds and pence calculation.

Of course the loan payments being affordable on this basis might be an indication that a consumer could sustainably make the repayments. But it doesn't automatically follow that this is the case. And as a borrower shouldn't have to borrow further in order to make their payments, it follows that a lender should realise, or it ought fairly and reasonably to realise, that a borrower won't be able to sustainably make their repayments if it is on notice that they are unlikely to be able to make their repayments without borrowing further.

I've carefully considered the information Mr B has provided in light of all of this.

The information I've been provided with shows that that Mr B was gambling unsustainable amounts of money. In these circumstances, I don't think that UK Credit would have lent if it knew, as I think it ought to have, that Mr B owed so much on payday loans because of his gambling. And that his ability to repay this loan would, to in all intent and purpose, be based on his success as a gambler.

Bearing all of this in mind, I'm satisfied that reasonable and proportionate checks would more likely than not have demonstrated that Mr B would not have been able to make the repayments to this loan without borrowing further and/or suffering undue difficulty. And, in these circumstances, I find that reasonable and proportionate checks would more likely than not have alerted UK Credit to the fact that Mr B would not be able to sustainably make the repayments to this loan.

Did UK Credit act unfairly or unreasonably towards Mr B in some other way?

I've carefully thought about everything provided. Having done so, I've not seen anything here that leads me to conclude UK Credit acted unfairly or unreasonably towards Mr B in some other way.

So I find that UK Credit didn't act unfairly or unreasonably towards Mr B in some other way.

conclusions

Overall and having carefully thought about the two overarching questions, set out on page eight of this decision, I find that:

- UK Credit *didn't* complete reasonable and proportionate checks on Mr B to satisfy itself that he was able to repay his loan;
- reasonable and proportionate checks *would* more likely than not have shown Mr B was unable to sustainably make the repayments to this loan;
- UK Credit *didn't* also act unfairly or unreasonably towards Mr B in some other way.

The above findings leave me concluding that UK Credit unfairly and unreasonably provided Mr B with a guarantor loan in December 2013.

Did Mr B and Miss V lose out as a result of UK Credit unfairly and unreasonably providing Mr B with this guarantor loan?

The statement of account, and breakdown of payments provided show that Mr B only made six payments to this loan. So he got nowhere near repaying the initial £8,000 that he was advanced and I don't think that he lost out financially as a result of having taken this loan – if anything, at the time the loan was settled at least, he was more than £6,000 in profit, at least in capital terms.

Miss V made one payment and then she cleared the outstanding balance with a lump sum payment in June 2018. As far as I can see Miss V voluntarily took this action *before* the guarantee was enforced. That said, I think that Mr B being provided with this loan, in these circumstances, led to UK Credit receiving more than it lent on a loan that it should never have provided in the first place. And as Miss V was the party that ended up paying these interests and charges, I find that it is Miss V who suffered adverse consequences and as a result lost out because UK Credit unfairly provided Mr B with this loan.

fair compensation – what UK Credit needs to do to put things right for Mr B and Miss V

I've carefully thought about what UK Credit should do to put things right in this case. This is an unusual case because the guarantor voluntarily decided to settle the outstanding balance – before the guarantee agreement was enforced – only a few months into a five year term.

Bearing this in mind, I think that it would be fair and reasonable in all the circumstances of this particular complaint for UK Credit to put things right in the following way:

- refund Miss V the extra that was paid over and above the £8,000 initially advanced on this loan (any payments Mr B made should be treated as having gone towards repaying the £8,000 lent to him);
- add interest at 8% per year simple on the extra paid from the date it was paid by Miss V to the date of settlement†;

† HM Revenue & Customs requires UK Credit to take off tax from this interest. UK Credit must give Miss V a certificate showing how much tax it has taken off if he asks for one.

my final decision

For the reasons I've explained, I'm upholding Mr B's complaint. UK Credit Limited should put things right for Mr B in the way I've set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr B and Miss V to accept or reject my decision before 14 September 2019.

Jeshen Narayanan
ombudsman