

GOUGH SQUARE CHAMBERS' CONSUMER CREDIT COLUMN: JANUARY 2020

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James Ross, Ruth Bala, Thomas Samuels and Lee Finch are all specialist consumer credit counsel at Gough Square Chambers. On a regular basis, they will share their views with Practical Law Financial Services subscribers on topical developments or key issues relating to consumer credit.

In the January 2020 column, Ruth Bala provides a summary of the different categories of regulated and unregulated mortgages, some of which will also be classified as regulated credit agreements under the Consumer Credit Act 1974 (CCA).

by *Ruth Bala, Gough Square Chambers*

CATEGORISING YOUR MORTGAGE

Lawyers like to categorise and subdivide: it enables us to impose some order upon the facts. Categorising your mortgage is the critical first step when faced with a mortgage misselling claim, or any other allegation of regulatory non-compliance involving a mortgage. If you have not identified the product category, then you will not be able to identify which regulatory requirements applied at the relevant date.

I summarise the various categories below, but this is only a high-level summary and the detail of the legislation must always be checked.

Regulated mortgage contracts

If you suspect that your product might be a “regulated mortgage contract”, you should first ascertain whether it was entered into pre-or post-21 March 2016, this being the date the Mortgage Credit Directive Order 2015 (*SI 2015/910*) (MCD Order) came into force, implementing the Mortgage Credit Directive (*2014/17/EU*) (MCD) in the UK. The MCD Order radically amended the definition of a regulated mortgage contract in article 61 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (*SI 2001/544*) (RAO).

If the credit agreement was entered into pre-MCD, then to be a regulated mortgage contract it must (in summary) be secured on a dwelling (i) of the borrower (or their relative) and (ii) by a first charge. However, neither of these requirements applies to post-MCD regulated mortgages, which may be secured by a second charge on a dwelling of a third party.

A pre-MCD regulated mortgage will be governed by the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB) in the FCA Handbook, unless it is a “legacy mortgage” entered into before the commencement of the FCA’s regulation of mortgages on 31 October 2004.

For more information on the definition of a regulated mortgage contract, see *Practice note, What is a regulated mortgage contract?*.

If the regulated mortgage is post-MCD, the next task is to identify which MCOB provisions apply. There are two basic sub-categories of post-MCD regulated mortgages.

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MCD regulated mortgage contracts

“MCD regulated mortgage contracts” are defined in the FCA Glossary. Essentially, they are post-MCD regulated mortgage contracts where the borrower is a “consumer” and which are not “MCD exempt regulated mortgage contracts” (see *MCD exempt regulated mortgage contracts*).

Accordingly, regulated mortgage contracts which are entered into for business purposes without being exempt (for example, mortgages secured by a first charge which are not “investment property loans”) cannot be MCD regulated mortgage contracts, even if they are entered into post-MCD, as the borrower is not a consumer.

MCD regulated mortgage contracts are governed by special MCOB chapters, often ending with “A” (for example, MCOB 2A, 4A and 5A).

MCD exempt regulated mortgage contracts

The second sub-category of post-MCD regulated mortgages is “MCD exempt regulated mortgage contracts”. One example is an “MCD exempt bridging loan”, described in Article 4(23) of the MCD as:

“A credit agreement either of no fixed duration or which is due to be repaid within 12 months, used by the consumer as a temporary financing solution while transitioning to another financial arrangement for the immovable property”.

Another example is an “MCD exempt lifetime mortgage”, which is an equity release product (for example, where repayment is only due upon the borrower’s death or their moving into long-term care).

MCD exempt regulated mortgage contracts should comply with the old pre-MCD MCOB rules, unless the creditor elects to comply with the special MCD MCOB rules (*MCOB 1.2.16 R (1)*).

Unregulated mortgages

I have divided unregulated mortgages into seven basic sub-categories.

Over-limit second charge

“Over-limit agreements” (my terminology) are those which pre-date 5 April 2008 (when the monetary cap on regulation by the Consumer Credit Act 1974 (CCA) was removed) and where the amount of credit exceeded the applicable cap (£25,000, but £15,000 for pre-1998 agreements).

If such mortgages are secured by a second charge, then they cannot be regulated mortgages (they will necessarily be pre-MCD). Neither will they be “regulated credit agreements” as they exceed the monetary cap.

Legacy mortgages

Legacy mortgages pre-date the commencement of the FCA’s regulation of mortgages on 31 October 2004 and therefore cannot be regulated mortgages. However, it should be checked whether they are regulated credit agreements.

Mortgages secured on commercial property

These cannot be regulated mortgages (whether entered pre- or post-MCD), because the security property is not a “dwelling”. They are also exempt from being regulated credit agreements as “non-residential property loans”.

Mortgages secured on buy-to-lets

These are again exempt from being regulated credit agreements as non-residential property loans. It is unlikely that they are regulated mortgage contracts, although this is possible if they are post-MCD. If they are pre-MCD

they cannot be regulated mortgages because the security property is not a dwelling “of the borrower” (or their relative). If they are post-MCD, they will probably be exempt as investment property loans. However, if they do not pass the special business purposes test for buy-to-let mortgages, or if the presumption based on the business purposes declaration is inapplicable or rebutted, then they may be “consumer buy-to-let (CBTL) mortgages”. These are a type of regulated mortgage, but subject to a secondary system of regulation.

For more information on CBTL mortgages, see [Practice note, FCA consumer buy-to-let mortgage regime](#).

Business purposes

Mortgages entered into for business purposes will be exempt from being regulated credit agreements if the amount of credit exceeds £25,000. They will not be regulated mortgage contracts if secured by a second charge: pre-MCD they would not fall within the primary definition of a regulated mortgage and post-MCD they will fall within the “second charge business purposes” exemption. If they are secured by a first charge then they may be regulated mortgage contracts if secured on the borrower’s home (and therefore not exempt as an investment property loan).

High net worth borrowers

Mortgages with high net worth borrowers will be exempt from being regulated credit agreements if the exemption criteria are met. However, the exemption is specifically disapplied from MCD regulated mortgage contracts (article 60HA, RAO).

Borrowers who are not “individuals”

If the borrower is a company or a large partnership then the mortgage will not fall within the primary definition of a regulated mortgage contract. Neither will the borrower fall within the definition of “debtor” in section 189 of the CCA.

Regulated credit agreements

Finally, some mortgages will be regulated credit agreements. In addition to the candidates already considered (for example, legacy mortgages and business purposes mortgages where the amount of credit is lower than £25,000 and which are not regulated mortgages), there are two principal sub-categories.

Consumer credit back book mortgages

These are pre-MCD mortgages, secured by a second charge on a dwelling. They were regulated credit agreements when entered, but post-MCD they fall within the amended definition of a regulated mortgage contract. The regulatory position is that MCOB applies from 21 March 2016 (the date of the MCD Order), but there are also transitional CCA provisions that apply (for example, notices, enforcement orders and “unfair relationships”).

Art 3(1)(b) mortgages

MCD regulated mortgage contracts are covered by Article 3(1)(a) of the MCD. By contrast, “article 3(1)(b) mortgages” are post-MCD mortgages that are not regulated mortgage contracts. There are three elements to their definition:

- They are not MCD regulated mortgage contracts (since Article 3(1)(a) and 3(1)(b) of the MCD are mutually exclusive).
- The purpose of the credit agreement is “to acquire or retain property rights in land”.
- The borrower is a “consumer”.

An example is a mortgage which is secured on commercial property (and thus is not a regulated mortgage contract), where the purpose of the mortgage was to finance the purchase of property.

Pursuant to article 60B(3) of the RAO, article 3(1)(b) mortgages are regulated credit agreements and many of the exemptions from being a regulated credit agreement are disapplied from article 3(1)(b) mortgages (for example, the exemption for non-residential property loans).

However, article 3(1)(b) mortgages are excluded from the definition of a "consumer credit agreement" in section 8(3) of the CCA. Therefore, while the creditor requires FCA permission to carry on the article 60B RAO activities, the creditor need not comply with the CCA formalities.

Although art 3(1)(b) mortgages are not regulated mortgage contracts, there are a host of applicable MCD MCOB rules; these are specified in MCOB 14.1.3R(1). There are also a few rules in the Consumer Credit sourcebook (CONC) that are applicable (specified in CONC 1.2.8R).

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