

GOUGH SQUARE CHAMBERS' CONSUMER CREDIT COLUMN: APRIL 2017

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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 share their views with Practical Law Financial Services subscribers on topical developments or key issues relating to consumer credit.

In the April column, Thomas Samuels considers whether loans secured by way of charge on land will fall within either the FCA's consumer credit regime or its mortgage regime.

by *Thomas Samuels, Gough Square Chambers*

SECURED LOANS AND THE CONSUMER CREDIT REGIME

Introduction

There are very limited circumstances in which a loan agreement, whether formal or between family and friends, that is secured by way of charge on land will be regulated by the consumer credit regime. In most cases, loans to consumers secured on land come within the definition of a regulated mortgage contract and are covered by the FCA's mortgage regime.

Regulatory overview

In the first instance, it should be borne in mind that a loan covered by the Consumer Credit Act 1974 (CCA) is only one of many activities regulated by the FCA. Therefore, even if a proposed loan is not CCA-regulated, it may come within the definition of some other regulated activity that requires FCA authorisation.

Lending to non-commercial entities (whether consumers, sole traders or small partnerships) secured by charges on land is most likely to come within the definition of either a regulated credit agreement or a regulated mortgage contract. They are defined by articles 60B and 61 respectively of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (*SI 2001/544*) (RAO). The definitions and differences between the two regulated activities are set out in further detail in *Regulated credit agreements versus regulated mortgage contracts* below.

However, before considering either definition, it should be remembered that an activity (even if it comes within the definition in the RAO per se) will only engage the majority of obligations if it is "carried on by way of business" under section 22(1) of the Financial Services and Markets Act 2000 (FSMA). In the vast majority of cases, relatively informal or one-off lending between family and friends will not be. As such, whether a regulated mortgage contract or regulated credit agreement, it is likely that such loans will not be subject to any particular drafting or procedural requirements (although the unfair relationship provisions of the CCA continue to apply whether the agreement is a regulated or an exempt credit agreement).

For further detail on the meaning of carried on by way of business, see:

- *Article, Gough Square Chambers' consumer credit column: September 2015.*
- *Article, Gough Square Chambers' consumer credit column: February 2016.*
- *Practice note, Carrying on regulated activities by way of business.*

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Regulated credit agreements versus regulated mortgage contracts

If the would-be lender may be acting by way of business, it is necessary to consider which regulated activity is being carried on. The starting point must be the definition of a regulated mortgage contract since this is most likely to cover a loan secured on land. Since an agreement cannot be covered by both the mortgage and consumer credit regimes, the definition of a regulated credit agreement is only relevant if the agreement is not a regulated mortgage contract.

The definition of a regulated mortgage contract was amended with effect from 21 March 2016. It now has four elements:

- A contract under which one person (“the lender”) provides credit to an individual or to trustees (“the borrower”).
- Where the borrower’s obligation to repay is secured by a mortgage on land in the EEA.
- At least 40% of that land is to be used, or is intended to be used, in the case of credit provided to:
 - an individual, as or in connection with a dwelling; or
 - a trustee which is not an individual, as or in connection with a dwelling by an individual who is a beneficiary of the trust, or by a related person.
- Which does not fall within articles 61A(1) or (2) of the RAO.

There are three primary points to note about the definition.

First, as indicated by the fourth bullet point above, it must be read in conjunction with article 61A of the RAO, which defines the applicable exemptions to the regulated activity of entering into a regulated mortgage contract. The details of those exemptions are largely outside the scope of this column. However, of particular note are “second charge business” and “investment property” loans as defined by article 61A(6). Equivalent exemptions apply to both regulated mortgage contracts and regulated credit agreements, meaning that a proposed loan is likely to be exempt from both or neither of the regulated activities.

Secondly, the definition of borrower is narrower than that in the definition of a regulated credit agreement under article 60B, which refers to credit provided to “an individual or relevant recipient of credit...”. In particular, a “relevant recipient of credit” includes a small partnership of two or three persons not all of whom are bodies corporate, or an unincorporated body of persons not all of whom are bodies corporate (*article 60L(1), RAO*).

Thirdly, the definition of a regulated mortgage contract (as the name suggests) only covers mortgages. A mortgage is defined simply as including “a charge and (in Scotland) a hereditament” (*article 61(4)(a), RAO*). Although article 61 previously referred to security by way of “a first legal mortgage”, it now also covers second and subsequent mortgages. Moreover, it is to be assumed from the simple reference to “a charge” in the definition of mortgage, that it would include both legal and equitable charges. For further clarification it may be useful to consider the very broad definition of mortgage in section 205(1)(xvi) of the Law of Property Act 1925 (LPA). It includes “any charge or lien on any property for securing money or money’s worth”.

In any event, restrictions or interests noted on the Land Registry, but which are not formally secured by a CH1 or equitable charge, will fall outside the definition of a regulated mortgage contract.

For more information on the definition of a regulated mortgage contract, see [Practice note, What is a regulated mortgage contract?](#).

Scope of application of consumer credit regime to secured agreements

A new secured loan is only likely to come within the consumer credit regime in circumstances where either:

- It is made to a partnership or unincorporated association, rather than an individual or trustee.
- The lending is secured by something other than a charge or lien, such that the security falls outside the definition of a mortgage.

(For the avoidance of doubt, any loan where the security is over property that does not meet the 40% dwelling threshold will also be exempt from being a regulated credit agreement by virtue of article 60D of the RAO.)

The result is that the vast majority of secured loan agreements will fall outside the scope of the consumer credit regime and, instead, will be regulated mortgage contracts.

EXAMPLE

A loan of £100,000 from a parent to a child to purchase a property that is secured by way of second charge over the property (behind a high street mortgagee) would come within the definition of a regulated mortgage contract. The same is very likely to be true for a short-term loan between friends, which is secured by a first or second charge.

Agreements entered into before 21 March 2016

Regulated credit agreements versus regulated mortgage contracts and *Scope of application of consumer credit regime to secured agreements* above set out the position in relation to new loans. However, the analysis is different for loans entered into before 21 March 2016, when the definition of a regulated mortgage contract under article 61 of the RAO was amended following the UK transposition of the Mortgage Credit Directive (2014/17/EU) (MCD).

For secured loans entered into on or before 20 March 2016, only first legal mortgages were covered by the definition of a regulated mortgage contract. Any equitable mortgage, or second or subsequent legal charge, securing a loan made to an individual or relevant recipient of credit will have come within the definition of a regulated credit agreement. Accordingly, unless either not entered into by way of business or exempt under articles 60C-H of the RAO, such agreements should have complied with the requirements of the CCA.

For more information on the RAO exemptions referred to, see *Practice note, What is a regulated credit agreement?: Is the credit agreement an exempt agreement?*.

Legal consequences of classification

Regulated mortgage contracts must comply with the FCA's rules and guidance in its Mortgages and Home Finance Conduct of Business sourcebook (MCOB). In particular, as set out above, lending secured by a mortgage to a consumer is governed by the mortgage regime, which is set out in various chapters of MCOB. However, the FCA Handbook applies only to "a firm" that is defined as an authorised person (MCOB 2.1.1R). Since authorisation is required only for persons carrying on the relevant activity by way of business, for the reasons given above, the MCOB rules will not apply to most informal or one-off loans.

In any event, assuming authorisation is properly in place, failure to comply with MCOB of itself does not have the same harsh consequences as failure to comply with the consumer credit regime. Instead, it simply gives rise to a cause of action for breach of statutory duty under section 138D of FSMA.

Where a secured loan comes within the consumer credit regime, the position as to drafting and procedure is particularly complex. The reason is that secured lending is expressly excluded from the scope of the Consumer Credit Directive (2008/48/EC) (CCD). Accordingly, unless a lender chooses to “opt-in”, none of the reforms to the CCA made by the CCD apply and none of the consumer credit statutory instruments dating from 2010 are relevant.

Even if a lender does opt-in to the CCD regime, certain requirements are inapplicable in any event. For example, in certain circumstances a lender can choose to comply with the executed copy requirement under section 61A of the CCA (per section 61A(6)) but cannot choose to give a right to withdraw under section 66A (per section 66A(14)).

Therefore, in the event that a would-be lender wants to enter into a secured loan that falls within the consumer credit regime, it is strongly advisable to take specialist advice. The complexity of the parallel and interwoven CCD and non-CCD requirements within the regime mean that what is required is not always obvious and costly mistakes can be easily made.

Gough Square Chambers’ consumer credit columns

For previous consumer credit columns written by barristers at Gough Square Chambers, see [Practice note, Gough Square Chambers’ consumer credit columns](#).