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Gough Square Chambers' consumer credit column: February 2021

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Ruth Bala, Lee Finch, Sabrina Goodchild and Thomas Samuels 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 February 2021 column, Lee Finch considers certain exemptions from the regulated activity of consumer credit lending in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (*SI 2001/544*) (RAO).

Exemptions from regulated consumer credit lending

Introduction

Thankfully not all lending is regulated. When I loan one of my colleagues £5 to buy their lunch, I am not engaging in a regulated activity (although if I start charging interest, I may have to reconsider my regulatory position).

As in the example given, the position is often obvious, but there are significant grey areas and answering the question correctly is crucial. This is because getting it wrong and engaging in the regulated activity of consumer credit lending without the appropriate permission from the FCA has serious financial and, potentially, criminal consequences.

Three points worth noting:

- Firstly, a lender will not be engaging in the regulated activity of consumer credit lending if they are not acting "by way of business" (see section 22 of the Financial Services and Markets Act 2000 (FSMA) and the column from February 2016).
- Secondly, a lender will not be engaging in the regulated activity of consumer credit lending if the debtor falls outside the definition of "individual" (see section 189(1) of the Consumer Credit Act 1974 (CCA)) and "relevant recipient of credit" (see article 60L of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (*SI 2001/544*) (RAO)): that is, persons who are neither natural persons, or partnerships consisting of two or three persons (not all of whom are bodies corporate), or unincorporated bodies of persons which do not consist entirely of bodies corporate.
- To put it another way and speaking generally, lending to companies and large partnerships falls outside the scope of the RAO and the CCA and is therefore unregulated.
- Thirdly, even if the lending is carried out by way of business and is to an "individual" or "relevant recipient of credit", there are a number of exemptions that may mean FCA permission is not required and much of the CCA does not apply.

This column provides a high-level introduction to those exemptions, explains the continued applicability of the unfair relationship regime and notes some recent and pending developments.

What are the exemptions?

The regulated activity of consumer credit lending is defined by article 60B of the RAO and, unsurprisingly, the exemptions can be found at articles 60C to 60H RAO. The key exemptions, and the ones which this column will focus on, are the:

- Regulated mortgage contract exemption (*article 60C(2), RAO*) (see Regulated mortgage contract exemption).
- Business purposes exemption (*article 60C(3), RAO*) (see Business purposes exemption).
- Short-term, interest free, debtor-creditor-supplier exemption (*article 60F, RAO*) (see Short-term, interest free, debtor-creditor-supplier exemption).
- High net worth exemption (*article 60H, RAO*) (see High net worth exemption).

For an overview of all exempt agreements under the RAO, see Practice note, What is a regulated credit agreement?: Is the credit agreement an exempt agreement?.

Regulated mortgage contract exemption

Unsurprisingly, article 60C(2) of the RAO exempts agreements that are covered by the mortgages regime. This prevents the headaches that would arise from having to comply with two distinct sets of regulation.

In particular, it is noteworthy that article 60C(2)(c) exempts agreements that were previously regulated consumer credit agreements (that is, second charge mortgages) before the regulatory realignment on 21 March 2016. However, when dealing with such "consumer credit back book mortgage contracts", care should be exercised as there are important saving provisions in the Mortgage Credit Directive Order 2015 (*SI 2015/910*), which ensure that despite the transfer to the mortgages regime and the article 60C(2)(c) exemption, consumers nevertheless retain certain protections they enjoyed under the consumer credit regime.

Business purposes exemption

Article 60C(3) of the RAO exempts agreements that are for credit exceeding £25,000 and entered into by the debtor wholly or predominantly for business purposes. Obviously, the debtor's intention when borrowing is not usually within the creditor's direct knowledge and, for added protection, it is usually advisable for creditors to include a declaration from the borrower that they are entering the agreement for business purposes.

Provided this declaration complies with the requirements in CONC App 1.4, and the lender does not know or have reasonable cause to believe the declaration is false (see, for example, *Wood v Capital Bridging Finance Ltd [2015] EWCA Civ 451*), a presumption arises that the agreement was, in fact, entered for business purposes.

Short-term, interest free, debtor-creditor-supplier exemption

Article 60F(2) of the RAO exempts debtor-creditor-supplier agreement for fixed-sum credit where the repayments exceed neither 12 in number or 12 months in duration (starting on the date of the agreement) and the credit is provided without interest or other charges.

This is the exemption which allows "buy-now-pay-later" (BNPL) credit, where payment for goods is made by a small number of monthly or quarterly instalments rather than at point of purchase, to be provided without FCA permission. It is also the exemption utilised by the "credit hire" industry to provide replacement vehicles to individuals involved in road traffic accidents, and usually consequent legal proceedings, without immediate charge.

High net worth exemption

Article 60H of the RAO exempts agreements secured on land or for credit exceeding £60,620 provided that the borrower:

- Meets certain requirements.
- Completes a declaration within the agreement agreeing to forgo the protections and remedies applicable to regulated agreements.
- Provided a statement of high net worth to the lender.

The scope of the exemption, the form and content of the declaration and the high net worth statement are all set by FCA rules (see CONC App 1.4). It is important these strict requirements are met. If they are not, the exemption will not apply and the lending will be regulated.

Since 21 March 2016, this exemption has been limited by article 60HA of the RAO, which ensures that agreements falling within the scope of the Mortgage Credit Directive (*2014/17/EU*) (MCD) are not exempt from regulation. This means that consumer credit agreements secured on residential land and consumer credit agreements entered into for the purpose of acquiring or retaining rights in land, or an existing or projected building, will not be exempt agreements, even if the high net worth exemption would otherwise apply.

Continued applicability of the unfair relationship regime

Whilst lenders do not require FCA permission to enter into exempt agreements and the vast majority of the CCA does not apply (by virtue of most sections referring to "regulated agreements"), it is important to note that the unfair relationship provisions in sections 140A to 140C of the CCA continue to apply.

This is because the sections refer to "credit agreements" rather than "regulated agreements" and a specific definition of "credit agreement" is provided by 140C(1) of the CCA, which covers any lending to an "individual". Consequently, even if the lending in question is exempt by virtue of, for example, the business purposes exemption, the debtor will still be able to bring an unfair relationship claim. The only exception to this is the exemption for regulated mortgage contracts, which is specifically imported into the unfair relationship provisions by section 140A(5) of the CCA.

Recent and proposed changes to exemptions

Following the end of the Brexit transition period, a number of amendments were made to articles 60C

to 60HA of the RAO on "IP completion day". These amendments will need to be considered carefully in any given case. However, it is noted that, whilst some of the changes seem to limit the ambit of article 60HA to reverse the impact of the MCD, care must be exercised as a new article 4(4B) preserves the pre-IP completion day position for certain agreements, adding further complexity to some already rather impenetrable regulation.

Further changes may also be coming down the track. On 2 February 2021, following a recommendation in the Woolard Review, HM Treasury announced that BNPL credit agreements will be regulated by the FCA. To achieve this, a legislative amendment will be required to article 60F(2) of the RAO. Although Christopher Woolard's recommendations in this area were limited to BNPL credit, it will be important to carefully analyse any legislative change as it is more than possible that any amendment to article 60F(2) of the RAO will have broader ramifications.

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 column.