

GOUGH SQUARE CHAMBERS' CONSUMER CREDIT COLUMN: OCTOBER 2016

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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 October column, Ruth Bala considers FCA regulated consumer buy-to-let (CBTL) mortgages.

Ruth Bala, Gough Square Chambers

CONSUMER BUY-TO-LET MORTGAGES

The consumer buy-to-let (CBTL) mortgage is a new regulatory concept introduced by the Mortgage Credit Directive Order 2015 (*SI 2015/910*) (MCDO), which came into force on 21 March 2016. The MCDO introduces a regulatory framework to govern CBTL mortgages by making amendments to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (*SI 2001/544*) (RAO). Those practising in this area need to be able to identify a CBTL mortgage since, unlike most buy-to-let lending, it is subject to regulatory oversight.

The UK Treasury made the MCDO to implement the Mortgage Credit Directive (*2014/17/EU*) (MCD). The MCD was designed to foster a single European market for mortgages; although the MCD covers both residential and buy-to-let (BTL) mortgages, the MCD affords member states a discretion not to apply its provisions to BTL lending. If this discretion is exercised, as it was by the UK, then the member state must instead develop a "national framework" for BTL lending. The UK's CBTL mortgage regime represents that national framework. It is a secondary system of regulation, without the full panoply of obligations and protections that would otherwise arise.

Since the MCD only governs consumer mortgages, the UK devised its national framework so that it was restricted to CBTL mortgages. This means that the vast majority of BTL mortgages will continue to be advanced outside the FCA's jurisdiction, as they will be for business purposes and therefore exempt as "investment property loans".

Definition of a CBTL mortgage

To understand the definition of a CBTL mortgage, one must first understand the amended definition of a "regulated mortgage contract" (RMC) in article 61 of the RAO. As most readers will be aware, the MCDO radically extended the definition of an RMC, so that it now includes loans secured by second, as well as first, charges. Another lesser known extension was to remove the requirement that the security dwelling is occupied by the "borrower" (or a relative of the borrower). It was this latter amendment that enabled the creation of the concept of a CBTL mortgage, as the security property could now be occupied by a third party tenant. A CBTL mortgage is a sub-category of the new RMC.

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

A BTL mortgage is defined in article 4 of the MCDO; in this column I shall only cover the most common type of BTL mortgage, which is that secured on residential property. This type of BTL mortgage is defined as an RMC that includes a contractual term that the property:

RESOURCE INFORMATION

RESOURCE ID

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RESOURCE TYPE

Article

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JURISDICTION

Any UK jurisdiction,
United Kingdom



- Cannot at any time be occupied as a dwelling by the borrower (or by a related person).
- Is to be occupied as a dwelling on the basis of a rental agreement.

Essentially, therefore, a BTL mortgage is a species of RMC where the security property must be rented as a dwelling by a third party.

A CBTL mortgage is simply a BTL mortgage that is not entered into by the borrower wholly or predominantly for business purposes. If a BTL mortgage is entered into wholly or predominantly for business purposes, then it will be exempt from regulation as an investment property loan. To identify whether a BTL mortgage is a CBTL mortgage or an investment property loan, Parliament has devised a specific business purposes test for the BTL context. I shall consider the application of this test after concluding my summary of the regulatory framework (see [Special business purposes test](#) below).

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

Exclusion from regulated activities

Since, definitionally, CBTL mortgages are a subset of RMCs, entering and administering CBTL mortgages *prima facie* constitutes the regulated activities of entering and administering RMCs (*article 61, RAO*). However, the UK's "national framework" governing CBTL mortgages was only designed to subject these loans to a secondary system of regulation, not to the full FCA authorisation scheme. Accordingly, the level of regulation is taken down a notch by means of an "exclusion" from carrying on regulated activities (*article 72I, RAO*). This exclusion covers a variety of regulated activities, including those specified by article 61. It is offered to firms undertaking CBTL mortgage business on the condition that they are entered on the CBTL mortgage register.

Registration and its relationship to authorisation

The CBTL mortgage register is held by the FCA to record those firms that are registered to carry on CBTL mortgage business. If a firm already has permission relating to another activity under Part 4A of the Financial Services and Markets Act 2000 (FSMA), the FCA must enter it onto the register if it applies in a manner that complies with the article 9 procedure (*article 8(1) and (2), MCDO*). If the firm is not already an authorised person, then it will need to pass various fitness requirements to become a registered CBTL mortgage firm (*article 8(1) and (3), MCDO*).

Once a firm is on the register, it must comply with the detailed requirements in Schedule 2 to the MCDO. These include conduct of business obligations, competence requirements for staff, pre-contract requirements and obligations surrounding interest rate changes, management of arrears and repossession.

By virtue of the article 72I RAO exclusion, a firm that is on the register does not need Part 4A permission to carry on CBTL mortgage business. It follows that unauthorised firms may legitimately carry on CBTL mortgage business. However, if they do so without being on the register, they will be unable to benefit from the exclusion and will be contravening the general prohibition and committing a criminal offence.

If a firm is already FCA authorised (for example, because it enters into RMCs generally), it cannot simply rely on its permission to carry on the regulated activity of entering into RMCs; it must also ensure that it is entered on the CBTL mortgage register. This is because its permission to carry on the article 61 RAO activities will be subject to a "requirement" that it must be on the CBTL mortgage register if it wishes to carry on CBTL mortgage business (*article 7, MCDO*).

Special business purposes test

As stated above, whether BTL lending is entirely exempt from regulation, or subject to the CBTL mortgage framework depends on whether the borrower is acting "wholly or predominantly for business purposes". Parliament has devised a specific business purposes test to suit the context of BTL lending. The need for this

is obvious: simply receiving rental income from an unrelated third party living in the security property must be insufficient to make the loan one for “business purposes”, otherwise the concept of a CBTL mortgage could not exist.

There are two alternative routes here: proof (satisfying the statutory business purposes test in article 4(4) of the MCDO), or presumption (including the prescribed business purposes declaration).

The statutory route to prove business purposes in article 4(4) of the MCDO has two alternative limbs itself. In summary, route (a) is that the borrower has already purchased the security property (or is purchasing it with the loan), with the intention to let it to an unrelated third party as a dwelling, and it has never been the borrower’s home. Route (b) is that the borrower already owns another buy-to-let property (other than the security property).

Delving into the legislative detail of these tests is outside the scope of this article. Essentially, the added ingredient, besides receipt of rental income, which makes a BTL mortgage for business purposes will be that the loan is used to finance the purchase of the property, or that the property has always been a BTL since purchase, or that the borrower has a number of BTL properties.

It is noteworthy that BTL mortgages to finance the purchase of the security property will not generally be CBTL mortgages. This is because where an individual enters a BTL mortgage to finance the purchase of the property, they have made an active decision to acquire a property to become a landlord, and are therefore acting in a business capacity.

It will be much more common for BTL mortgages secured on previously purchased property to be CBTL mortgages. For instance, a CBTL mortgage could be secured on a property that has previously been lived in by the borrower, but which the borrower is unable to sell and so lets instead. BTL mortgages secured on inherited property are also likely to be CBTL mortgages.

If neither of the two alternative routes in article 4(4) of the MCDO applies, or their application is uncertain, it is open to the lender to rely on the business purposes declaration (presumption rather than proof).

Potential issues

This is a new regime and its limits have yet to be tested. Tantalising potential issues that may arise include the following:

- Where a BTL mortgage is secured on a previously purchased property, is the statutory test to prove business purposes satisfied where it is met by one of two joint borrowers?
- Is the application of the “unfair relationship” provisions to CBTL mortgages, and exempt investment property loans, an unintended consequence of the November 2015 amendment to article 60C(2) of the RAO?
- In relation to the business of administering CBTL mortgages, is it open to a firm to rely on the article 62 or 63 RAO exclusions instead of applying to be on the register?
- Is an unauthorised broker, who acts as a mere introducer to a CBTL mortgage lender, able to rely on the article 72I RAO exclusion from carrying on the article 25A RAO activity of arranging RMCs? If not, what are the consequences?