



COUNCIL of MORTGAGE  
LENDERS

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**Consumer Credit Act 1974 (As amended by the Consumer Credit Act 2006)  
Consultation relating to Buy-to-let lending, provision of statements, definition of "payments"**

**Response by the Council of Mortgage Lenders**

**to the BERR consultation paper**

**6 March 2008**

**Introduction**

1. The Council of Mortgage Lenders (CML) is pleased to respond to the BERR consultation paper *Consumer Credit Act 1974 (As amended by the Consumer Credit Act 2006) Consultation on proposals relating to Buy-to-let lending, provision of statements, definitions of "payments"*
2. The CML is the representative trade body for the residential mortgage lending industry. Its 157 members currently hold over 98% of the assets of the UK mortgage market. In addition to lending for owner-occupation, the CML members undertake most of the buy-to-let (BTL) lending in the UK.
3. Because of the CML focus on mortgage lending, this response only deals in detail with the BTL issue. However, the CML has consulted with the British Bankers Association (BBA) in relation to the issues of statements and payments, and is supportive of the BBA position on these matters.
4. This response has been prepared following consultation with the CML Consumer Credit Act (CCA) and CML BTL working groups of members.

**BTL and CCA regulation**

5. The CML supports the position of HM Government that BTL should not fall within the scope of CCA regulation and supports the main thrust of the proposals contained within the present consultation paper, though with some modest suggestions for refinement (See paragraph 16 below). The issue of CCA regulation of BTL has arisen as an unintended consequence of the CCA 2006.
6. Government has consistently made it clear that it is not their intention to regulate BTL lending, as such lending is essentially commercial in nature. The CML supports this position. In addition, the regulation of first charge mortgage loans under the CCA would undermine the clear regulatory division by which first charge lending, where regulated, is regulated under the Financial Services and Markets Act 2000 by the FSA. To regulate BTL lending under the CCA would, thus, go against the thrust of regulatory policy within the UK. It should also not be forgotten that the EU Consumer Credit Directive (EU CCD), to be implemented in the UK by 2010, excludes all secured lending from its scope, thus increasing the difficulties inherent in using the CCA for the regulation of mortgages.

7. According to CML figures, there were over one million BTL loans outstanding in the UK by the end of 2007, with new BTL lending totalling £55 million in 2007. These loans perform consistently better than the mortgage market as a whole: in December 2007 arrears of more than three months stood at 0.73% compared to 1.1% for the wider mortgage market. Possessions were running at 0.18% compared to 0.23% for the whole mortgage market. The BTL market has been a real success story for the industry. The new investment represented by BTL has contributed significantly to raising the standards in the private rented sector, which, according to the *Survey of English Housing*, shows levels of tenant satisfaction higher than for either the local authority or housing association sectors. HM Government supports the need for an expanded private rented sector to house those for whom owner occupation or social renting are not appropriate. It is important that unintended regulatory consequences do not cut across this important policy aim by reducing the availability of BTL finance, by increasing the cost or by restricting product choice (See below).

### **Cost of regulation**

8. Typically BTL lenders use systems and practices closely related to those required under FSMA when originating and administering BTL lending. These systems are, thus, not compatible with the requirements of CCA lending. Because government has consistently voiced its intention not to bring BTL within the scope of CCA regulation, lenders have made no provision for such regulation within their IT and other systems, or within their training programmes, etc. Many BTL lenders have no systems capable of dealing with secured CCA lending at all.

9. In late 2006, the then DTI commissioned Price Waterhouse Coopers (PWC) to produce a report *Review of implementation timetable for Consumer Credit Act 2006* (March 2007). The CML submitted evidence on the costs of CCA regulation of BTL lending to PWC and directly to DTI. That report concluded that there would be over £100 million of transitional costs associated with gearing up for CCA regulation of BTL with ongoing annual costs of £500,000 per year. These figures demonstrate the scale of costs that would ultimately be borne by borrowers were BERR not to pursue the course proposed in the consultation paper. It was very doubtful whether the industry would have been able to be ready by April 2008 in any case, so that withdrawal of products from the market and withdrawal of some lenders entirely would have been an inevitable consequence of no action being taken to deal with this unintended consequence.

### **Uncertainty and lack of choice**

10. The potential cost of CCA regulation is increased by the legal uncertainty that would be created were no action to be taken. As the consultation paper makes clear the lifting of the £25,000 upper limit for CCA loans would, in conjunction with the business exemption produce a situation where loans for smaller BTL borrowers or those purchasing their first BTL properties would be CCA regulated while others would not. Worse still, the issue of regulation would have to be decided on a case by case basis with the consequence of an incorrect decision by the lender being possible unenforceability of the loan. This position was spelt out in an opinion commissioned from Malcolm Waters QC by the CML which was accepted in essentials by DTI/BERR. This level of uncertainty would inevitably inhibit product diversity and customer choice. It would also further discourage many smaller lenders from remaining within the BTL market at all.

11. Not only would customer choice be adversely affected but there would, in effect, be a two-tier division in the BTL product range. Those larger investors able to access unregulated loans could well be able to take advantage of cheaper products and of product features (such as initial discounted rates) which would be technically impossible to offer within the CCA regime. Such a situation would be confusing for borrowers and not in their interests. It

would also be unnecessarily complex for lenders who would, in general, prefer to offer a common product range to all potential BTL borrowers.

### **No level playing field**

12. As the consultation paper correctly points out, there would be no level playing field for all lenders in relation to BTL were no action to be taken. Under the Consumer Credit (Exempt Agreements) Order 1989, a number of lenders, mainly banks and building societies, could gain substantial (though not full) exemption for BTL lending even after the abolition of the £25,000 upper limit. However, a significant number of lenders (mainly non-deposit takers) would not qualify for this exemption so that there would be competitive advantage for some lenders and not for others. The lenders not qualifying for exemption under the 1989 Order include some of the largest players in the BTL market.

13. Clearly, this position is anti-competitive and unsatisfactory. Regulation should apply to all participants within a particular market or to none. It cannot be in the interests of borrowers for a significant and innovative group of lenders to be edged out of the market through their products being forced to bear the costs of regulation not borne by their competitors.

### **The BERR proposals**

14. The CML and its members support the proposals set out by BERR in the consultation paper, though two specific amendments are proposed below. In general terms the proposals address the problem identified and take an approach to defining BTL (less than 40% of the property occupied by the borrower or connected person) that coheres with the definition of a Regulated Mortgage Contract (RMC) under FSMA. The proposed solution also has the virtue of simplicity and clarity. The CML and DTI/BERR itself had explored the possibility of amending the business exemption to exclude all BTL from the scope of the CCA, but such a solution would have been difficult to achieve with sufficient clarity, particularly in relation to activities such as remortgaging and further advances. The solution as proposed by BERR avoids the need for a "purpose test" in relation to BTL mortgages and is this consistent with lending practice under FSMA.

15. In addition, the CML believes that the proposals meet the preconditions for an LRO in the key respects:

- Non-legislative solutions. There are no viable non-legislative solutions to the problem of partial regulation of BTL under the CCA. This is an unintended legal consequence arising from the abolition of the £25,000 upper limit for CCA loans in the 2006 Act. It can only be dealt with by amending the relevant legislation if the unacceptable consequences set out in paragraphs 7-13 are to be avoided.
- Proportionality. The consequence of doing nothing would be costs running into hundreds of millions of pounds to be passed onto borrowers with no countervailing benefit. In addition, borrowers would be confronted with a reduced choice of product and provider. By contrast, the proposed solution is a modest amendment with effects that do not go beyond the problem it is intended to address.
- Fair balance. The CML believes that the public interest will be well-served by dealing with this legislative anomaly. The solution will enable the full range of lenders to efficiently fund investment in the private rented sector on terms that will contribute to continued expansion and improvement in standards. This is widely acknowledged to be an important aim of public policy. There is no threat to the public interest in avoiding the unnecessary costs of regulating what are commercial transactions.

- Necessary protection. The BERR proposals do not remove any existing protections. They essentially preserve the status quo in relation to the regulation of BTL borrowing and to the regulation of secured borrowing in general. There had never been a policy intention to disrupt this position.
- Rights and freedoms. The proposals do not restrict any existing rights and freedoms exercised by lenders or by borrowers.
- Constitutional significance. The CML does not believe that the proposals have constitutional significance.

### **CML suggested amendments to the BERR proposals**

16. While believing that the BERR proposals are the right approach to dealing with the outstanding problems in relation to BTL lending, the CML has two suggestions for amendments to deal with residual issues. References are to the text of the draft order:

- 16C (3) Insert after "that" "at the time the agreement is entered into". The intention of this amendment is to deal with a situation where a borrower's position changes after the loan has been agreed. It would be undesirable for the regulatory status of the loan to change because the borrower subsequently moved into 40% or more of the property for instance. Such a situation would be outside the lender's control, the new position could be unknown to the lender and there would be a risk that the loan would be unenforceable if CCA regulatory requirements had not been complied with.
- 16C (6,7,8,9) Delete these sections and insert a provision for the lender to provide a form of words to the borrower prior to entering the agreement to the effect that the loan is unregulated and that certain specified conditions, therefore, do or do not apply. The form of words to be decided by the lender subject to their conveying the information specified. The present provision for a declaration to be signed by the borrower does not sit easily with the increasing use of information technology in the transaction process which is tending towards eliminating requirements for the borrower to sign documentation, particularly when the transaction is online. The need to obtain a signature on a declaration would cut across this trend towards innovation. The CML believes that a form of words providing the specified information to the borrower would fulfil the policy intention of protecting the customer while allowing for modern approaches to financial services transactions.

### **A clear case to act**

17. The CML is confident that BERR has made a clear case for action with regard to the question of the regulation of BTL lending. The alternative would be to witness increased costs to the borrower, a diminution of product diversity and a reduction in the choice of provider. The action proposed is necessary, proportionate and appropriate.

### **Contact**

18. This response has been prepared by the CML in consultation with its members. Comments and queries should be addressed in the first instance to Andrew Heywood, Deputy Head of Policy:

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