How to make loans to individuals in compliance with all regulatory requirements – a recent recap from the case of Kumar v LSC Finance Ltd

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As a general rule, no one is permitted to make loans to individuals unless they are regulated by the FCA, permitted to do so and comply with various other regulatory requirements. Contrary to popular belief, this can include loans to friends, family, employees and business partners. Failure to comply may make such loans unenforceable and constitute criminal activity. There are many exceptions to this rule (seven in total) and this note summarises key considerations when entering into these arrangements, as seen from the recent case of *Kumar v LSC Finance Ltd*.

Every instance of making loans available to individuals needs close scrutiny given that the consequences of getting this wrong are so severe.

When making a loan to an individual secured over land, there is an exception for investment property loans (i.e. buy-to-lets), whereby at the time of making the loan:

(a) the borrower does not intend to use more than 40% of the property as a dwelling for themselves; and

(b) the loan is entered into wholly or predominantly for a business purposes.

The recent case of *Kumar v LSC Finance Ltd* involved an unregulated lender making loans available to individual borrowers secured against various plots of land for which they had planning permission to develop into houses. When the loans defaulted, the borrowers argued that the loans were unenforceable because the lender had made prohibited regulated mortgages, which could result in the borrowers only repaying the loan amounts borrowed but not any interest or other fees. In this case, the court determined that the loans were enforceable because they were "investment property loans", for which the lender did not need to be regulated.

However, it is vital to note that these cases are determined on their facts and therefore it is imperative to closely scrutinise whether a lender is complying with regulatory requirements whenever making a loan to an individual. If a lender is relying on an exemption from the regulatory regimes, key considerations include:

(1) clearly document in the loan agreement that the parties intend that the arrangements fall within the relevant exemption(s), including an acknowledgement from the borrower that this will deprive them of the benefits of protections and remedies of a regulated arrangement. Legislation includes prescribed forms of wording for such exemption declarations, however questions were raised in the Kumar case because the loan agreement used an incomplete form of wording. In Kumar the declaration had been drafted using the regulated credit agreement mandated wording, as opposed to the wording applicable to regulated mortgage contracts. As such, even though the court found (based on underlying evidence) that the loans

were exempt from regulation, they concluded that the declaration was defective. This case therefore highlights the technical compliance of business exemption declaration and that consideration may still be given to it in the court's fact-finding exercise to determine business purpose;

(2) ensure that the loan agreement includes a statement of the purpose of the loan, plus any representations and restrictions necessary to ensure that it falls within the requirements of the relevant regulatory exemption; and

(3) recommend that the borrower obtains their own legal advice regarding the arrangements.

"No one may make a loan to an individual unless they comply with various regulatory requirements. Failure to comply may render the loan unenforceable and can be a criminal activity. It is therefore vital to closely scrutinise each transaction to ensure regulatory compliance"

Next steps

If you have a query that you would like to discuss, please get in touch with one of our specialists.