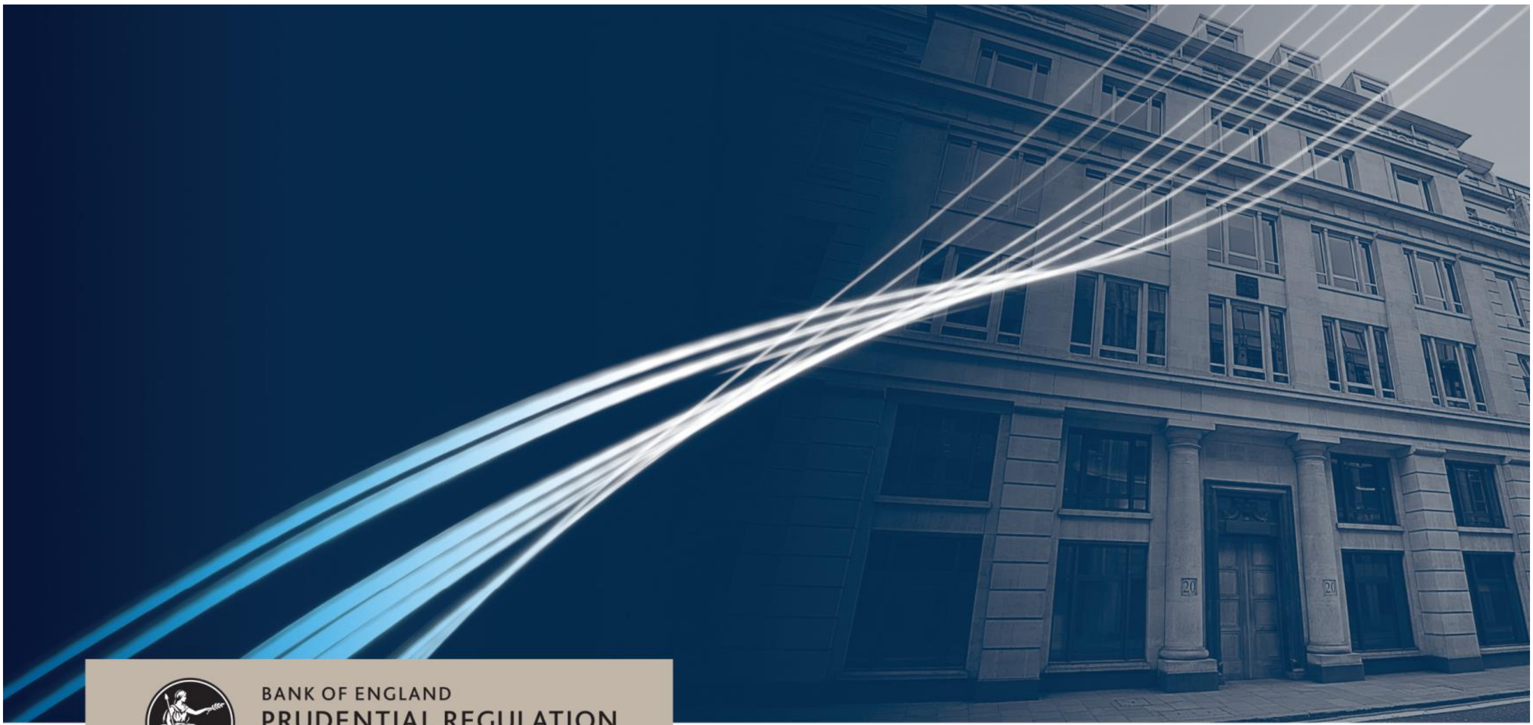

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP11/16

Underwriting standards for buy-to-let mortgage contracts

March 2016

Prudential Regulation Authority
20 Moorgate
London EC2R 6DA

Prudential Regulation Authority, registered office: 8 Lothbury, London EC2R 7HH.
Registered in England and Wales No: 07854923

Consultation Paper | CP11/16

Underwriting standards for buy-to-let mortgage contracts

March 2016

The Bank of England and the Prudential Regulation Authority (PRA) reserve the right to publish any information which it may receive as part of this consultation.

Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure, in accordance with access to information regimes under the Freedom of Information Act 2000 or the Data Protection Act 1998 or otherwise as required by law or in discharge of our statutory functions.

Please indicate if you regard all, or some of, the information you provide as confidential. If the Bank of England or the PRA receives a request for disclosure of this information, the Bank of England or the PRA will take your indication(s) into account, but cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system on emails will not, of itself, be regarded as binding on the Bank of England and the PRA.

Responses are requested by 29 June 2016.

Please address any comments or enquiries to:
Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

Email: CP11_16@bankofengland.co.uk

Contents

1 Overview

1.1 This consultation paper (CP) seeks views on a supervisory statement which sets out the Prudential Regulation Authority's (PRA's) proposals regarding its expectations of minimum standards that firms should meet when underwriting buy-to-let mortgage contracts. The proposals also include clarification regarding application of the small and medium-sized enterprise (SME) supporting factor[1] on buy-to-let mortgages.

1.2 The supervisory statement follows a PRA review of underwriting standards in the buy-to-let sector which covered 31 firms (c.92% of the market). This review highlighted concerns about lenders' growth plans and how they might meet them. In particular, there is a risk that firms relax underwriting standards, thus affecting their safety and soundness. The findings suggested a need for microprudential action.

1.3 The PRA's proposals seek to ensure that firms conduct their buy-to-let business in a prudent manner. They aim to prevent a marked loosening in buy-to-let underwriting standards and to curtail inappropriate lending and the potential for excessive credit losses.

1.4 The PRA's proposals to clarify expectations in relation to application of the SME supporting factor are aimed at enhancing the transparency and consistency of the PRA's regulatory approach.

1.5 The PRA's proposals also support the Financial Policy Committee's ability to act from a macro-prudential perspective.

1.6 Chapter 2 outlines the PRA's proposals. Chapter 3 considers the PRA's statutory obligations in relation to the proposals. Appendix 1 details the draft supervisory statement.

Scope and application

1.7 The CP proposes:

(i) a set of expectations for firms that underwrite UK buy-to-let mortgage contracts where the land is intended to be occupied as a dwelling on the basis of a rental agreement, in pounds sterling, regardless of whether the borrower is an individual or limited company; and

(ii) a clarification in relation to application of the SME supporting factor on buy-to-let mortgages.

1.8 Paragraph 1.7(i) is relevant for all PRA-regulated firms that undertake buy-to-let lending that are not already subject to Financial Conduct Authority (FCA) regulation. The FCA regulates buy-to-let lending to related persons through their Mortgages and Home Finance: Conduct of Business sourcebook and lending in relation to consumer buy-to-let mortgage contracts through the Mortgage Credit Directive Order 2015[2]: the PRA's proposals do not apply to either of these types of lending. The PRA will also expect regulated firms to ensure that the standards contained in the supervisory statement are adopted by other firms undertaking buy-to-let lending within their groups. To avoid existing borrowers being adversely impacted when remortgaging, the proposals referred to in paragraph 1.7(i) do not apply to buy-to-let re-

1 The SME supporting factor is defined in Article 501 of the CRR. It is used to reduce capital requirements on loans to SMEs on qualifying retail, corporate and real estate exposures by approximately 24%.

2 A 'consumer buy-to-let mortgage contract' means a buy-to-let mortgage contract which is not entered into by the borrower wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the borrower.

mortgages where there is no additional borrowing beyond the amount currently outstanding under the existing buy-to-let contract. Paragraph 1.7(ii) is relevant to all firms bound by the Capital Requirements Regulation (575/2013) (CRR).

Responses and next steps

1.9 This consultation closes on Wednesday, 29 June 2016. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to CP11_16@bankofengland.co.uk.

2 Proposals

Affordability testing

2.1 Affordability tools constrain the value of the loan that a firm can extend for a given income and can reduce the probability of default on the loan particularly in an environment of rising interest rates. At higher levels of indebtedness, borrowers are more likely to encounter payment difficulties in the face of shocks to income and interest rates.

2.2 Rental income is an important factor when determining the ability of buy-to-let landlords to service their debt. Accordingly, a widespread market practice in the buy-to-let lending market is to use the mortgage’s interest coverage ratio (ICR) in assessing affordability. In addition to rental income, some borrowers use personal income to support their ability to service their debt.

2.3 The PRA is therefore proposing that all firms use an affordability test when assessing a buy-to-let mortgage contract in the form of either:

- an ICR test; and/or
- an income affordability test, where firms take account of the borrower’s personal income to support the mortgage payment.

2.4 The PRA is seeking to establish a standard set of variables that should be reflected within the ICR test and the income affordability test. To ensure that firms are being prudent in their affordability assessment, the PRA is proposing that firms, among other things, give consideration to:

- all costs associated with renting out the property where the landlord is responsible for payment;
- any tax liability associated with the property; and
- where personal income is being used to support the rent, the borrower’s income tax, national insurance payments, credit commitments, committed expenditure, essential expenditure and living costs.

2.5 As affordability constrains the value of the loan a firm can extend, the PRA is not at this time proposing supervisory guidance with respect to specific loan-to-value (LTV) standards. However, the PRA does expect firms to have appropriate controls in place to monitor, manage and mitigate the risks of higher LTV lending.

Interest rate affordability stress test

2.6 The buy-to-let market is characterised by floating, or relatively short-term fixed mortgage rates typically on an interest-only basis. These attributes heighten the sensitivity of buy-to-let lending to changes in interest rates, which increase debt service costs.

2.7 Consequently, the PRA proposes that, when assessing affordability in respect of a potential buy-to-let borrower, firms should take account of likely future interest rate increases. In particular, the PRA proposes that the firm should consider the likely future interest rates over a minimum period of five years from the expected start of the term of the buy-to-let mortgage contract, unless the interest rate is fixed for a period of five years or more from that time, or for the duration of the buy-to-let mortgage contract if less than five years. In coming to a view of likely future interest rates, the PRA would expect firms to have regard to:

- market expectations;
- a minimum increase of 2 percentage points in buy-to-let mortgage interest rates[1]; and
- any prevailing Financial Policy Committee (FPC) recommendation and/or direction on the appropriate interest rate stress tests for buy-to-let lending.

Even if the interest rate determined above indicates that the borrower's interest rate will be less than 5.5% during the first 5 years of the buy-to-let mortgage contract, the firm should assume a minimum borrower interest rate of 5.5%.

Portfolio landlords

2.8 The PRA is seeking to establish a standard definition of what constitutes a 'Portfolio landlord'. Under this proposal, a landlord would be considered to be a Portfolio landlord where they have four or more mortgaged buy-to-let properties across all lenders in aggregate. Data gathered by the PRA shows that there is an increase in observed arrears rates of landlords with buy-to-let portfolios of four or more mortgaged properties.

2.9 The PRA is expecting that firms conducting lending to Portfolio landlords do so according to a specialist underwriting process that accounts for the complex nature of the borrower and their portfolio of properties.

Risk management

2.10 The PRA is proposing that firms have robust risk management, systems and controls in place specifically tailored to their buy-to-let portfolios. These should include risk appetite statements governing how core risks will be identified, mitigated and managed and monitoring of portfolio concentrations and high risk segments.

2.11 The buy-to-let market is dominated by lending originated through intermediaries. There is some concern that firms with weaker underwriting standards may be adversely selected which could result in a concentration of a particular risk on individual firms' balance sheets. Consequently, the PRA expects firms to have appropriate oversight and monitoring capabilities with respect to their intermediary business.

The SME supporting factor in relation to buy-to-let mortgages

2.12 The PRA proposes to enhance the transparency and consistency of the PRA's regulatory approach by clarifying the PRA's expectations in relation to application of the SME supporting factor on buy-to-let mortgages.

2.13 Under Article 501 of the CRR the SME supporting factor is used to reduce by approximately 24% the capital requirements on loans to SMEs on qualifying retail, corporate and real estate exposures. The PRA does not consider that buy-to-let borrowing falls within the objective of the SME supporting factor described in Article 501 CRR. The PRA proposes to

1 Buy-to-let mortgage interest rates can refer to either origination rates or reversionary rates. The PRA is not prescribing a specific interest rate, but lenders should be able to justify the approach taken for the purposes of the affordability test.

clarify in the supervisory statement that it expects firms to consider the intended purpose of a loan before applying the SME supporting factor. The SME supporting factor should not be applied where the purpose of the borrowing is to support buy-to-let business. The PRA would expect firms to comply with the spirit and intent of this statement.

3 The PRA's statutory obligations

3.1 As set out in the consultation paper, the proposals are compatible with the PRA's statutory objectives under the Financial Services and Markets Act 2000 (FSMA) to promote the safety and soundness of PRA-authorised firms.[1]

3.2 In making its rules and establishing its practices and procedures, the PRA must have regard to the Regulatory Principles as set out in FSMA.[2] In drafting this CP, the PRA had regard to the Regulatory Principles. In particular, the burdens and restrictions resulting from the expectations contained in the supervisory statement have been assessed and are considered to be proportionate to the benefits, considered in general terms, which are expected to result. This CP is also intended to help facilitate sustainable growth in the economy of the United Kingdom in the medium and long-term by curtailing excessive lending that is imprudently underwritten and/or under-priced.

Cost benefit analysis

3.3 The baseline used in the cost benefit analysis below incorporates the effects of the tax changes announced by HM Government in 2015[3] which are expected to affect the buy-to-let market.

Costs

3.4 These proposals are expected to generate direct implementation costs for the PRA and for buy-to-let lenders. The PRA will incur costs associated with data collection and compliance monitoring, which are not expected to be significant. Separately to the proposals in this Consultation Paper, the Bank intends to collect data needed for systematic monitoring of underwriting standards and other terms and conditions on buy-to-let mortgage lending to support its monetary policy responsibilities, though the data will also be useful for financial stability and micro-supervisory purposes. The data collection for the buy-to-let market, which will be consulted on separately, will include fields required by supervisors and policy makers to monitor compliance with the proposals set out in this CP. PRA supervisors already monitor prudential risks emanating from firms' buy-to-let lending. The additional direct costs for the PRA from the measures in this CP are therefore expected to be insignificant.

3.5 The incremental direct costs to regulated firms are not expected to be material either, because buy-to-let lenders already use a stressed interest rate in their assessment of ICRs and affordability. Similarly, we do not expect the requirement to perform a verified income affordability test, where firms take account of the borrower's personal income, to lead to significant direct costs for firms as few buy-to-let investors rely on their personal income to support their buy-to-let activities. Buy-to-let lenders who are also active in residential lending

1 See s.2B(1) and s.2B(2) FSMA.
2 See s.2H and s.3B FSMA.
3 In the Summer Budget 2015, HM Government announced changes to the tax relief that can be claimed by buy-to-let landlords. From April 2017 mortgage interest tax relief for higher and additional rate tax payers in the buy-to-let market will be reduced. The change restricts the relief that can be claimed to 20% of mortgage interest payments and will be phased in over four years. Most firms are yet to incorporate the impact of these tax changes into their ICR tests, although they are in the process of developing new policies and procedures to take these additional costs into account.

already have the processes in place to carry out this assessment for their lending to owner-occupiers.

3.6 The buy-to-let market is expected to continue growing after the implementation of the proposals set out in the CP. However, when compared with the baseline absent of the proposals, it is estimated that the proposals will lead to a decrease in the number of cumulative new approvals for buy-to-let mortgages by about 10-20% by Q3 2018, and correspondingly, a lower value of the stock of buy-to-let mortgages. The number of buy-to-let mortgage approvals and the value of stock of buy-to-let mortgages will also depend on the extent to which firms and borrowers respond to the recent tax changes and other developments in the housing market.

3.7 Any reduction in buy-to-let activity and lower buy-to-let mortgage stock will lead to a reduction in short-term revenues for lenders and mortgage brokers. While affected firms may be able to recover some of the reduction in revenues by lending to owner-occupiers or other business activities in the economy, we think some more affected firms may find it difficult to recover lost revenues. Some buy-to-let investors could see an impact on their ability to obtain a buy-to-let mortgage and/or the profitability of their lending activities due to higher deposit requirements. However, affected investors may be able to find returns in other investment opportunities.

3.8 If firms currently apply the SME supporting factor in a way that is inconsistent with the expectations set out in the proposal in relation to application of the SME supporting factor on buy-to-let mortgages, those firms could face an increase in their minimum capital requirements following the proposals. For those firms, this could have a negative impact on buy-to-let growth aspirations. However, given the available information, the PRA estimates that the amount of lending where risk-weightings might be affected as a result of this proposal is not material.

Benefits

3.9 The proposals on affordability testing aim to improve the safety and soundness of PRA regulated firms by ensuring that they take full account of any potential interest rate rises in their buy-to-let underwriting assessment. This will help curtail inappropriately risky and imprudent lending - loans that are affordable under the current low interest rates environment but will quickly become unaffordable if and when interest rates rise - and lower potential credit losses and repossession costs. As a result, these proposals are also expected to help insulate the lenders, the financial sector and wider economy from the impact of negative shocks in the housing market.

3.10 The benefits of the proposal in relation to application of the SME supporting factor on buy-to-let mortgages are an improvement in the safety and soundness of affected firms, and increased consistency and transparency of the PRA's regulatory approach.

Impact on competition

3.11 When making general policy, the PRA is required, in so far as is reasonably possible, to facilitate effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities.

3.12 Requiring lenders to conduct appropriate affordability assessments, including taking account of likely future interest rate increases and using a prudent level of stressed interest rate in their affordability assessment, could facilitate effective competition by preventing firms from under-pricing risk and creating barriers to entry and expansion for new and existing competitors who price and assess risk more prudently.

3.13 The proposal in relation to application of the SME supporting factor on buy-to-let mortgages is intended to ensure a more consistent application across firms and is therefore expected to facilitate effective competition.

3.14 The proposals will only apply in relation to buy-to-let contracts extended by firms regulated by the PRA, or firms that are part of a group within which a firm is regulated by the PRA. This could result in buy-to-let lenders outside the scope using a lower stressed interest rate in their assessment in an attempt to gain market share. However, the PRA notes that currently the number of lenders outside the scope of these proposals represents a small share of the buy-to-let market, and the PRA intends to monitor the developments in the buy-to-let market.

3.15 The PRA has consulted with the FCA in relation to the contents of this CP.

Impact on mutuals

3.16 The proposals will apply to firms regulated by the PRA, or firms that are part of a group within which a firm is regulated by the PRA, and the impact on mutuals will not be significantly different from the impact on other firms.

Equality and diversity

3.17 The PRA is required, under the Equality Act 2010, to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions. The PRA has made an assessment of this and does not consider that the proposals in this CP give rise to equality and diversity implications.

Appendices

---

1 **Draft Supervisory Statement - Underwriting standards for buy-to-let mortgage contracts**

Appendix 1: Draft Supervisory Statement - Underwriting standards for buy-to-let mortgage contracts

1 Introduction

1.1 This supervisory statement is relevant to all firms regulated by the Prudential Regulation Authority (PRA) that undertake buy-to-let lending that is not already subject to Financial Conduct Authority (FCA) regulation. The FCA regulates buy-to-let lending to related persons through their Mortgages and Home Finance: Conduct of Business sourcebook (MCOB) and lending in relation to consumer buy-to-let mortgage contracts through the Mortgage Credit Directive Order 2015[1][2]: this supervisory statement does not apply to either of these types of lending. The PRA expects regulated firms to ensure that the standards contained in this supervisory statement are adopted by other firms undertaking buy-to-let lending within their groups.

1.2 The purpose of this supervisory statement is to:

(a) outline the PRA's expectation of minimum standards that firms should use to underwrite buy-to-let mortgage contracts; and

(b) clarify the PRA's expectations in relation to application of the small and medium-sized enterprise (SME) supporting factor on buy-to-let mortgages.

1.3 For the purposes of paragraph 1.2(a), firms should consider a buy-to-let mortgage contract as a contract, under which:

(a) the lender provides credit to the borrower;

(b) the obligation of the borrower to repay is secured by a mortgage on land in the United Kingdom and in pounds sterling;

(c) at least 40% of the land is used, or is intended to be used, as or in connection with a dwelling; and

(d) the land subject to mortgage cannot at any time be occupied as a dwelling by the borrower or by a related person, and is to be occupied on the basis of a rental agreement.

1.4 To avoid existing borrowers being adversely affected when re-mortgaging, the expectations referred to in paragraph 1.2(a) do not apply to buy-to-let remortgages where there is no additional borrowing beyond the amount currently outstanding under the existing buy-to-let contract to the firm or to a different firm. In determining the amount currently outstanding, new arrangement fees, professional fees and administration costs should be excluded.

1.5 Firms should assess all buy-to-let mortgage contracts from the perspective of whether the borrower will be able to pay the sums due. The underwriting standards set out in this supervisory statement should form minimum standards, regardless of whether the borrower is an individual or a company.

1 Mortgage Credit Directive Order 2015: www.legislation.gov.uk/ukdsi/2015/9780111127742
2 A 'consumer buy-to-let mortgage contract' means a buy-to-let mortgage contract which is not entered into by the borrower wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the borrower.

2 Affordability testing

2.1 When assessing a buy-to-let mortgage contract, the PRA expects firms to:

(a) assess whether the income derived from the property is sufficient to support the monthly interest mortgage payments using an interest coverage ratio (ICR) test; and/or

(b) if firms are taking account of personal income as a means for the borrower to support the monthly interest mortgage payments, assess whether that income, in addition to any income derived from the property, is sufficient to support the mortgage payments using an income affordability test.

2.2 Firms should not base their assessment of affordability on the equity in the property which is used as security under the buy-to-let mortgage contract, or take account of a future increase in property prices.

Interest coverage ratio (ICR) calculation

2.3 The PRA expects firms to define the ICR as the ratio of the expected monthly rental income from the buy-to-let property to the monthly interest payments which take into account likely future interest rate increases as set out in paragraphs 2.12 to 2.17.

2.4 When determining the minimum ICR threshold, firms should take into account rental demand and typical rent levels within the property's locale. Expected rental income should be verified by a suitably qualified independent valuer.

2.5 When assessing the minimum ICR threshold, consideration should be given to the following costs where the borrower is responsible for payment: management and letting fees, council tax, service charge, insurance, repairs, voids, utilities, gas and electrical certificates, licence fee, ground rent and any other costs associated with renting out the property.

2.6 The PRA also expects firms to take into account any tax liability that is associated with the property. For the avoidance of doubt, this should include the tax changes announced by HM Government in the Summer Budget 2015 with respect to mortgage interest tax relief.

2.7 The current industry standard is to set the minimum ICR threshold at 125%. The PRA does not expect these proposals to reduce minimum ICR thresholds and furthermore, some of the factors above may lead to higher minimum ICR thresholds.

Income affordability test

2.8 Firms may use personal income as a means for the borrower to support the rent within their affordability test.

2.9 If firms use personal income as a means for the borrower to support the rent, the PRA expects firms to conduct a detailed affordability assessment of the borrower taking into account the following;

a) Income
   i) Examples of sources of personal income include employment income, rental income (from all of the borrower's properties), pensions, savings and investments.
   ii) Personal income should be net of income tax, national insurance payments and any tax liability that is associated with financing the property as referred to in paragraph 2.6.

iii) Firms should assess any rental income by taking into account rental demand and typical rent levels within the property's locale. Expected rental income should be verified by a suitably qualified independent valuer.
iv) If a firm is aware that there is likely to be a future change in the income of the borrower during the term of the buy-to-let mortgage contract, such as retirement, the firm should take this into account.
v) Firms should obtain evidence of the income of the borrower using appropriate methods of validation.

b) Credit commitments
   i) Examples of credit commitments include mortgages (from all of the borrower's properties), loans, motor finance and credit cards.
   ii) Firms should stress mortgage payments in line with the guidance/rules set by the FCA, PRA and the Financial Policy Committee.
   iii) Firms should obtain evidence of the borrower's credit commitments, for example by making a credit reference agency search or checking credit card or bank statements.

c) Essential expenditure and living costs
   i) Examples of essential expenditure related to the borrower are food, utilities, telephone, council tax, buildings insurance, ground rent and service charge for leasehold properties, essential travel and childcare.
   ii) Examples of essential expenditure related to the borrower's rental properties should include management and letting fees, council tax, service charge, insurance, repairs, voids, utilities, gas and electrical certificates, licence fee and ground rent.
   iii) Living costs are expenditure which is hard to reduce and gives a basic quality of life (beyond the absolute essential expenditure in (i)), such as clothing, household goods and repairs, personal goods and basic recreation.

d) Other committed expenditure
   i) Examples of committed expenditure are school fees, child and/or spousal maintenance costs.

2.10 In taking account of essential expenditure and living costs, a firm may obtain details of the actual expenditure. Alternatively, it may use statistical data or other modelled data appropriate to the composition of the borrower's household, including the borrower, dependent children and other dependents living in the household.

2.11 Firms should put in place, and operate in accordance with, a written policy detailing how income and expenditure is to be assessed.

Interest rate affordability stress test

2.12 When assessing affordability in respect of a potential borrower, firms should take account of likely future interest rate increases on affordability.

2.13 In taking account of likely future interest rate increases for the purposes of its assessment of whether the borrower will be able to pay the sums due, the firm should consider the likely future interest rates over a minimum period of five years from the expected start of the term of the buy-to-let mortgage contract, unless the interest rate is fixed for a period of five years or more from that time, or for the duration of the buy-to-let mortgage contract if less than five years.

2.14 In particular, in coming to a view of likely future interest rates, the PRA expects firms to have regard to:

(a) market expectations;

(b) a minimum increase of 2 percentage points in buy-to-let mortgage interest rates[1];and

(c) any prevailing Financial Policy Committee recommendation and/or direction on the appropriate interest rate stress tests for buy-to-let lending;

and must be able to justify the basis it uses by reference to (a), (b) and (c).

2.15 Even if the interest rate determined in paragraph 2.14 indicates that the borrower's interest rate will be less than 5.5% during the first 5 years of the buy-to-let mortgage contract, the firm should assume a minimum borrower interest rate of 5.5%.

2.16 An example of market expectations is the forward setting rate published on the Bank of England website. A firm should not rely only on its own forecasts. A firm should not link its determination to market expectations without considering the likely effect of rate changes in accordance with the market expectations on the specific buy-to-let mortgage contract in question.

2.17 Firms should put in place, and operate in accordance with, a written policy detailing how future interest rates are to be taken into account when assessing affordability.

3 Portfolio landlords

3.1 The PRA expects firms undertaking buy-to-let lending to have regard to the potential commercial nature of this type of business. The PRA considers that borrowers with four or more mortgaged buy-to-let properties should be treated as 'Portfolio landlords'.

3.2 The PRA expects firms to recognise that existing experience and skills acquired in buy-to-let lending do not automatically translate into equivalent skills when assessing Portfolio landlords. Lending to Portfolio landlords is inherently more complex given the quantum of debt in aggregate, the cash flows and costs arising from multiple tenancies and potential risks of property and/or geographical concentrations.

3.3 These complexities mean that a specialist underwriting approach is appropriate. Firms underwriting process for Portfolio landlords should assess:

(a) the borrower's experience in the buy-to-let market and their full portfolio of properties and outstanding mortgages;

(b) the assets and liabilities of the borrower, including any tax liability referred to in paragraph 2.6;

(c) the merits of any new lending in the context of the borrower's existing buy-to-let portfolio together with their business plan; and

1 Buy-to-let mortgage interest rates can refer to either origination rates or reversionary rates. The PRA is not prescribing a specific interest rate, but lenders should be able to justify the approach taken for the purposes of the affordability test.

(d) historical and future expected cash flows associated with all of the borrower's properties.

3.4 Firms should put in place, and operate in accordance with, a written policy detailing the differentiation between underwriting standards for buy-to-let lending and lending to Portfolio landlords.

4 Risk management

4.1 The PRA expects firms to have adequate risk management and controls specifically for buy-to-let lending, including:

(a) risk appetite limits on the flow and stock of buy-to-let lending, including ICR and loan-to-value (LTV) limits;

(b) appropriate oversight and monitoring of the risk profile of lending introduced by individual third party intermediaries;

(c) monitoring of portfolio concentrations and high risk segments; and

(d) controls to ensure that any fraud risks associated with buy-to-let lending are effectively managed.

5 The SME supporting factor in relation to buy-to-let mortgages

5.1 The PRA expects that the SME supporting factor (Article 501, Capital Requirements Regulation (575/2013) (CRR)) should not be applied where the purpose of the borrowing is to support buy-to-let business. This means that, in general, the PRA expects firms not to apply the SME supporting factor to exposures secured on residential property that is let out by the borrower.

5.2 There may be some limited circumstances where it is permissible for firms to apply the SME supporting factor to exposures secured on residential property that is let out. The PRA would expect firms to consider the intended purpose of the loan before applying the SME supporting factor in this way. If the primary purpose of the loan is to support buy-to-let business, the PRA would not expect the SME supporting factor to be applied.

5.3 As an illustration, an SME borrower might take out a loan for the acquisition of a residential property that it intends to let out, and the loan may be secured using that residential property as collateral. In such a circumstance the PRA would consider that the purpose of the loan is to support buy-to-let business, and we would expect the SME supporting factor not to be applied to that exposure.

5.4 As another illustration, an SME borrower may take out a loan with the purpose of investing to adopt new technologies and equipment to increase the competitiveness of the SME, and the loan may be secured on a residential property which they already own and let out. In such a circumstance, and where the other requirements for applying the SME supporting factor are met, the SME supporting factor could be applied.