Loan-based ('peer-to-peer') and investment-based crowdfunding platforms: feedback on post-implementation review and proposed changes to the regulatory framework

Peer-to-Peer Finance Association (P2PFA) response to CP 18/20

1. Executive Summary and Statement

1.1 Peer-to-peer lending in the United Kingdom has driven improvements for investors and borrowers in terms of customer experience and access to finance, facilitating more than £10 billion of loans. In addition to bringing competition to a market increasingly abandoned by traditional finance in the wake of the 2008 financial crash, peer-to-peer finance has expanded access to a retail investment opportunity which generates a higher rate of return than those available in bank deposits but reflects a risk profile generally lower than that available in equity markets.

1.2 The P2PFA has been consistent from its inception in 2011 in making the case for a proportionate regulatory regime which holds platforms to consistent standards designed to enhance levels of market confidence. The challenge for the post-implementation review of crowdfunding regulation in respect of peer-to-peer lending is to make sure that the requirements of all platforms in the sector ensure that robust business models can continue to meet investor and lender expectations even in changing macro-economic circumstances.

1.3 The P2PFA believes that the proposals in the Financial Conduct Authority (FCA)'s consultation paper are generally sensible, and that the standards already observed by the best platforms in the sector demonstrate examples of best practice in terms of risk management frameworks, product design (including encouraging investor portfolio diversification), loan book stress testing, wind-down planning for potential platform failure, governance and transparency.

1.4 These successes have been built on a regulatory foundation which, since the initial commitment of a number of platforms to the P2PFA's Operating Principles in 2011 and the subsequent introduction of the statutory regulatory regime in 2014, has been principles-based and focused on providing the space for the emergent sector to address the needs of the various lending markets served whilst growing levels of market confidence through an unparalleled commitment to transparency and disclosure.

1.5 Whilst the sector requires freedom to innovate and compete in a market which continues to be dominated by long-established incumbents, the post-implementation review of crowdfunding regulation also provides an opportunity to raise the commitment of all platforms in the sector to the standards observed by the best. The consultation is right to identify the breadth of business models which have emerged in the sector; identifying a single prescribed set of rules which will reflect the circumstances of all platforms is a major challenge, and does not take account of the continued innovation which is likely to continue. The P2PFA believes that a principles-based regulatory framework is the most appropriate regime for the sector, underpinned by an unimpeachable commitment to consistent disclosures and openness in terms of risk management.

1.6 In December 2017, the P2PFA tightened the commitments required of platforms in its Operating Principles and pledged that an annual review of these provisions would be undertaken. Changes in the requirements made of platforms included clearer expectations in terms of risk management; the introduction of mandatory resilience testing; explicit prohibition of any form of maturity transformation and wholesale lending; and, where a platform reaches a certain scale, specified arrangements for independent governance. The P2PFA's vision for the sector remains one where the requirements and expectations of platforms across the entire market meet the standards required of P2PFA platforms, so that investor confidence can continue to be enhanced.

1.7 In considering the P2PFA's response to the proposals contained in the consultation paper, we are especially keen to ensure that:

1.7.1 the ability of the peer-to-peer lending market to contribute to the health of the UK economy is not obstructed;

1.7.2 the variety across the peer-to-peer community – operating with different types of lending and borrowing customer – is recognised and there is no presumption that one size will fit all circumstances;

1.7.3 the market remains open to those investors and lenders who have a proper understanding and assent to the risks involved, including retail investors; and

1.7.4 the overall effect of the regime is proportionate and reflects a market which is continually evolving.

1.8 The P2PFA believes that its approach to establishing and encouraging high standards of business practice across the sector is consistent with the objectives and aspirations of the FCA as regulator. The regime needs to be framed to ensure that investor understanding is robust – particularly as the base of retail investors expands – and that platform models provide sufficient information about their approach to risk management and performance to enable informed decisions to be made.

2. Retail Investors and Marketing

2.1 The proposed rules on marketing give rise to our most significant questions and concerns. The advent of peer-to-peer lending has enabled retail investors to access an asset class otherwise restricted to institutional, sophisticated and high net worth participants. We firmly believe that this access is good for the market, for the investors and for those who raise finance on it.

2.2 If retail access is restricted, by an excessively narrow or mechanistic interpretation of who can participate, then this would have unintended and unfortunate consequences and would deny access to an investment product – largely configured from its outset with retail investors in mind to rates of return – which is superior to those available in bank deposit accounts and with a generally lower risk profile than that found in equity markets. Further, peer-to-peer lending provides an opportunity for retail investors to benefit from higher returns achievable because of technological efficiency in lending markets: connecting lenders and borrowers with lower overheads than is possible in traditional financial services. It is a priority for the P2PFA that the benefits of investing in loans through peer-to-peer platforms should continue to be available to retail investors with appropriate safeguards.

2.3 The proposed marketing restrictions bring peer-to-peer lending in line with equity crowdfunding and structured finance products. We do not think that this is appropriate given the fundamental differences between the risk profiles of these investments. Indeed, the investment offerings of P2PFA members – who we consider to be operating the highest standards in the sector – are sufficiently diverse that a uniform set of restrictions would not be appropriate.

2.4 We accept the need for appropriate safeguards: the key component of this will be a proper appreciation by lenders of the potential risks involved in peer-to-peer lending. This can be delivered effectively by platforms devising and operating their own robust, on-line test, comprising a series of questions and statements which prospective lenders would have to complete and to which they would have to confirm their assent before they could start the application process to make a lending decision. We would expect the test to be re-taken at intermittent intervals (but not on every return to the platform) so that lenders would be reminded of the implications of their participation.

2.5 The questions would not lead to a pre-determined outcome: we would expect a proportion of those taking the test to fail it and, in consequence, be unable to participate. We do not recommend a standard approach to appropriateness as the circumstances of individual platforms vary so significantly. But the P2PFA would expect to be working with our members to identify and share industry good practice; and to ensure that all platforms are aware of what has worked – and what has not. We would also expect to be sharing these ideas with the regulator.

2.6 We believe that this approach is far superior to any attempt to confine lending to pre-defined categories of individual, especially as the definition of those categories will have been drawn up with other classes of investment in mind. It should ensure that the consumer protection goals of the regulator are maintained; but it will also allow continued retail participation in an asset class which clearly helps investors attain their investment goals and where they allow borrowers to benefit from a retail funding stream and not be reliant merely on the volatility of the institutional funding market. This, in turn, will help the market, as a whole, make its contribution to the economic health of the nation.

3. Disclosures and the secondary market

3.1 Commitment to exemplary levels of transparency, compared with those observed elsewhere in the financial services marketplace, is a requirement of membership of the P2PFA: the adoption of consistent standards across the sector is to be welcomed. From the outset, this approach has served to enhance confidence in both individual platforms and across the sector, but it is important that this is not used as a vehicle to undermine (and undercut) individual businesses.

3.2 An effective disclosure regime, applied consistently across the sector, empowers investors to make informed decisions and provides appropriate protections to ensure that those investing are fully cognisant of the approach of an individual platform to risk assessment and management in the lending it facilitates, as well as in respect of the fees and costs which are incurred. Ensuring that investors are able to calibrate the risk and reward characteristics to reflect their own individual appetite must be a priority.

3.3 The FCA's proposals which require that a platform enables customers to have access to the on-going up-to-date value of a loan appears targeted to prevent defaulted loans being sold at par on the secondary market. We accept that there is a risk of harm to customers in discretionary platforms where customers are enrolled automatically to buy in the secondary market or where loans are not valued fairly. A clear commitment by all platforms to the fair pricing of loans including the re-pricing of downgraded or defaulted loans should be observed across the sector.

3.4 Although use of secondary markets in peer-to-peer lending has been relatively limited (lower than, or broadly comparable to, the average rate of transactions in retail equity investment funds), it is clear that the secondary market is valued as a potential source of liquidity. Peer-to-peer lenders should adopt an approach to secondary markets which eradicates the risk of consumer harm and prevents platforms from exaggerating returns to manipulate value.

3.5 It is important that the provisions in respect of disclosures serve to enhance the offering available to investors. We believe that designating peer-to-peer lending within the non-readily realisable securities regime is too restrictive, does not accurately reflect the nature of the market and could frustrate its development. Ultimately, this could undermine the interests of retail investors including those seeking to take advantage of the opportunities which the secondary market in peer-to-peer lending represents.

4. Conclusion

4.1 The regulatory regime which emerges at the conclusion of the post-implementation review process needs to be a market which remains open to the properly-informed and engaged retail investor.

4.2 Platforms unable, or unwilling, to meet the robust standards on disclosure observed by the best in the sector should be either prevented from entering the market or be eliminated from it. A clear, demonstrable commitment to investor empowerment through meaningful and comprehensible disclosures so that participants can make their own judgements about the approach and performance of a platform in respect of the offering it proffers is vital.

4.3 This is an important moment in the development of peer-to-peer lending in the UK; the pace of evolution in the sector lends itself to principles-based regulation with the risk that too prescriptive a rules-based approach will quickly become obsolete and outdated.

4.4 Peer-to-peer lending has made good progress in serving the needs of the wider economy and has stimulated innovation and competition in financial service markets. In taking forward the regulatory regime under which this success has been achieved, the focus on ensuring the needs of investors are at the forefront of platforms' considerations is welcome.

4.5 The P2PFA shares the FCA's objectives in seeking to develop the regulatory regime to raise the standards observed by all platforms in the UK peer-to-peer lending sector. We believe that the innovation and competition which has already been introduced into the financial services market by peer-to-peer lending has proven beneficial to the interests of customer experience, as well as for investor access to the returns offered and lending markets served.

4.6 The P2PFA looks forward to working closely with the regulator in taking forward these proposals and ensuring that peer-to-peer lending continues to offer a robust and valuable offering with strong protections for current and prospective investors.

APPENDIX: P2PFA RESPONSE TO QUESTIONS POSED IN CP 18/20

Equality & Diversity

Question 1: Do you have any comments on our assessment of the equality and diversity considerations?

The assumptions in paragraph 1.42 that the peer-to-peer lending investor base pose particular risks for individuals reliant on pensions (concerned about the impact of low interest rates on savings) and young, inexperienced investors (attracted to the concept without an understanding of the risks) is not consistent with the available data.

Evidence suggests that the typical investor is male and aged over fifty years. Peer-to-peer lending generally represents a small proportion of their total investment portfolio, and they spend a relatively significant amount of time each month managing their various interests. A representative survey conducted by Nesta[1] in 2014 to understand the awareness of alternative finance among the general population concluded that more than half of respondents who were investors in peer-to-peer lending were above fifty-five years of age.

Research published by the Cambridge Centre for Alternative Finance in December 2017[2] found that more than half of investors in both business and consumer lending through peer-to-peer finance platforms were aged over fifty-five years of age (fifty-seven and fifty-five per cent respectively); and that those in that age group investing in equity crowdfunding were just twenty-five per cent.

Similarly, the general implication that peer-to-peer lending constitutes a high-risk investment because of the relatively high returns ignores the fact that platforms can facilitate higher returns through technological and operational efficiencies which cannot be replicated by banks.

Crowdfunding business models

Question 2: Do you have any comments on the description of the business models in this section?

The evolution of business models across the peer-to-peer lending sector has reflected the features of the various markets which they serve. It is a useful exercise to seek to define models according to their characteristics, but it is not necessarily a simple matter of designating each platform into a single category – in particular the difference between conduit and pricing models could benefit from further differentiation.

Platforms operating a discretionary model should have to demonstrate robust controls and evidence to substantiate the marketing propositions which they promote. The tendency for investors using discretionary platforms to trust the 'brand' should not diminish the value of those businesses being required to justify the basis of the statements that they make. Discretionary models do not exist to obscure the underlying investment (unlike structured finance products) and have evolved to deliver simple projects that are suitable for retail investors, with investment products which are easy to understand, de-risk investment and stabilise returns.

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[1] Nesta, Understanding Alternative Finance (2014)
[2] Cambridge Centre for Alternative Finance: 4th UK Alternative Finance Industry Report (p.31), December 2017

Regulating different business models should be undertaken proportionately and be focused on the risks of potential market failure and averting the consequent consumer harm. Platforms are driven to innovate and develop distinctive business models which address the requirements of the different lending markets which they serve. The effect of the development of different business models has been to expand consumer choice and broaden effective competition in these markets.

Types of Harm

Question 3: Do you have any comments on the analysis of harm in this sector?

Peer-to-peer lending represents a novel form of financial service which offers investors a choice between the parameters of low risk (and low return) bank deposits and high risk (with potentially higher returns) equity-based investments: peer-to-peer lending has broadened the overall retail financial prospectus.

Harm should not be considered in isolation, but in the context of the corresponding benefits, and the suggestion in paragraph 4.58 of the consultation document that underlying loans are generally high risk is not borne out in practice.

Whilst the level of risk (and return) varies between different platform models and lending sectors served, the report prepared by Oxera[3] and submitted by the P2PFA alongside its submission to the FCA's call-for-input at the start of the post-implementation review process, concluded that the risk profile is 'similar to a portfolio of corporate loans, such as that provided by a corporate bond investment fund, except that P2P platforms facilitate loans mainly to individuals and SMEs rather than large companies'. Requiring platforms to disclose meaningful information about their management of risk, including enabling judgements to be made by investors about platform performance against their expectations and projections, allows informed decisions to be made about the potential exposure to risk which a particular product offering might represent.

Different business models across the peer-to-peer lending sector offer products which present investors with various profiles of risk: a flexible approach to the regulation of platforms across these different products should be adopted provided that investors are in no doubt whatsoever of the risks to which they are exposed and, in consequence, the returns which they might expect to receive. Each platform should develop a risk management framework which is appropriate for the type of lending it facilitates and prioritise how it communicates its approach so that investors can match their individual risk appetite with the investment opportunities available across a number of platforms in the sector. For example, within the P2PFA, investors with different platforms are able to facilitate loans which involve investing in parts of small loans in some cases and investing in whole loans in others; in these cases, it is not a simple exercise to compare the specific risk profiles between these platforms given the nature of the various offerings.

Experience to date suggests strongly that investors through P2PFA member platforms understand the capital and liquidity risks associated with peer-to-peer lending, and do not confuse it with, for example, bank deposit accounts. There is value in enabling retail investors an opportunity to diversify their investment portfolio, and with relatively appealing

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[3] 'The economics of peer-to-peer lending', (Oxera), September 2016 (www.oxera.com)

risk-reward properties and low levels of fees and charges, attractive net returns can be secured as a feature of peer-to-peer lending.

Platforms have sought to address potential harm by committing to good practice in explaining how peer-to-peer lending works in a simple, clear and balanced way to prospective investors in adherence to the existing regulatory framework. This includes making sure that marketing material conveys appropriate messages which are meaningful and informative so as to enable informed consumers to make effective comparisons in deciding whether and where to invest.

The P2PFA believes that steps to help individual investors understand the investment risk to which they would be exposed is most effectively carried out at the level of an individual platform, where the information can be presented in respect of understanding the characteristics of a specific investment product or opportunity rather than being communicated in terms of generic entry criteria. Accordingly, the onus must be on individual platforms to make sure that they prioritise adopting an approach to investor understanding of the risks to which any individual investment would be exposed, and presenting the platform's approach to managing that risk in a comprehensible, clear and transparent way.

In particular, the P2PFA's Operating Principles require platforms to publish data relating to returns performance and levels of default. Platforms must also disclose information about the costs, charges and risks in a clear and balanced way. Prospective investors should be able to make informed judgements about the approach an individual platform adopts in respect of specific risks and how these are reflected in a platform's performance against its own expectations.

Risk Management Framework

Question 4: Do you agree with our proposals to make clearer that P2P platforms that set the price of a loan must have an enhanced risk management framework that as a minimum allows the platform to:

(a) gather sufficient information about the borrower to be able to competently assess the borrower's credit risk;

(b) categorise borrowers by their credit risk in a systematic and structure way; and

(c) price the loan so it adequately and fairly reflects the credit risk determined in (a)?

If not, please explain why.

The P2PFA agrees with the proposals in the consultation paper in respect of risk management, provided they are implemented sensibly and proportionately. Some platforms do not price individual loans and the proposals do not provide clarity for those firms in that situation: in particular, there may be a need to incorporate some flexibility in the supervision of the rules to reflect the different business models of some platforms.

Question 5: What else do you think might be needed to ensure an appropriate risk management framework for a P2P platform that sets the price of a loan?

In December 2017, the P2PFA introduced a requirement in our Operating Principles on member platforms to carry out and publish analysis used to test for resilience in the event of adverse scenarios, including the range of expected losses in these scenarios. Whilst a prescriptive approach has not been adopted, it is reasonable that platforms should consider the impact on their loan book of various exogenous macro-economic scenarios and, despite the evident limitations in drawing conclusions solely on the basis of resilience testing, to analyse their own situation in the light of the circumstances modelled.

Question 6: Do you agree that when choosing P2P agreements on behalf of the investor, the platform must only facilitate those that are in line with the risk parameters advertised to the investor?

Yes, the P2PFA agrees that when choosing P2P agreements on behalf of the investor, the platform must only facilitate those that are in line with the risk parameters advertised to the investor.

Question 7: Do you agree with our proposals that P2P platforms that offer a target rate of return must be able to determine, with reasonable confidence, that a portfolio will generate the advertised target rate? If you do not agree, please explain why.

Yes, the P2PFA agrees that platforms offering a target rate of return must be able to determine, with reasonable confidence, that a portfolio will generate the advertised target rate.

Question 8: Do you agree that this means only exposing investors to loans that a platform has determined, with reasonable confidence, will contribute to achieving the advertised target rate of return and that, at the time of investment, fall within the risk parameters first advertised to the investor. If you do not agree, please explain why.

Yes, the P2PFA agrees that this means only exposing investors to loans that a platform has determined, with reasonable confidence, will contribute to achieving the advertised target rate of return and that, at the time of investment, fall within the risk parameters first advertised to the investor.

Question 9: Do you agree that a P2P platform's risk management framework must be adequate to assess price and value over time, i.e. for newly originated and, for example, for loans that have defaulted? If you do not agree, please explain why.

Assessing credit risks associated with particular loan applications is one of the most important elements of operating a peer-to-peer lending platform, and most P2PFA members have invested significantly in the capacity of the teams undertaking this work, supported by sophisticated infrastructure systems and controls. Where platforms have failed, one of the main factors identified has been deficient credit risk underwriting and, in consequence, the elimination of inadequate frameworks for managing credit and operational risk must be a priority.

Platforms operate different business models and, in consequence, their approach to applying rules relating to target rates of return and the assessment of price and value over time will also vary. In this context, flexibility in how platforms can manage target rates of returns and pricing commensurate with risk is essential.

Question 10: Is the high-level approach proposed the right one to allow the industry flexibility but ensure good standards? What else do you think might be needed to ensure an appropriate risk management framework for a P2P platform that chooses P2P agreement on behalf of investors?

Yes, the P2PFA agrees with the high-level approach proposed in the consultation paper. It is in any platform's interests to prioritise accurate credit risk management – not least as adverse default rates would impact swiftly upon their reputation and, ultimately, commercial viability. The speed of feedback in the digital economy gives platforms a self-regulating incentive and focus for effective credit management.

The P2PFA supports a high-level approach to ensuring good standards across the sector, and emphasises that the link between a platform's reputation and its ability to attract investors and borrowers should be robust – provided meaningful disclosures which reflect the reality of a platform's performance in credit risk assessment and management are mandated (and cannot be concealed), including the publication of expected, projected and actual performance in returns and default rates.

Governance

Question 11: Do you agree with our proposals that P2P platforms should have an independent compliance function and, depending on the nature, scale and complexity of its business, platforms should have independent risk and internal audit functions?

Yes, the P2PFA agrees that peer-to-peer lending platforms should have an independent compliance function and, when they reach an appropriate scale, should have independent risk and internal audit functions. Most platforms already have independent governance for compliance, with direct reporting to a senior director.

Question 12: Do you agree with our proposals that P2P platforms that have risk management frameworks should allocate responsibility for the development and oversight of that framework to a person approved to hold a significant influence function, such as a director?

The P2PFA accepts the proposals on governance provided that the principle of proportionality is applied and the scale of a platform's business is taken into account. As platforms grow, they should have plans to ensure independence for risk management and audit framework development.

Marketing Restrictions

Question 13: Do you agree with our proposals to apply marketing restrictions to P2P platforms? If not, please explain why.

The proposals on marketing restrictions are a cause of significant concern, and uncertainty about the future involvement of retail investors in peer-to-peer lending has arisen as a result. In particular, the application of marketing restrictions designed for other investment products with quite different characteristics could undermine the distinction recognised elsewhere in the consultation paper between peer-to-peer lending and other investments, including equity crowdfunding but also structured finance products which have the same restrictions.

The proposals align P2P lending with equity crowdfunding structure finance when the risk profiles of these two models are often fundamentally different to peer-to-peer lending. Where the largest and most successful peer-to-peer lending platforms have developed complex product offerings, this has been to provide investor protection. We also doubt that the investor classification proposals will provide better investor protection or improve investor understanding in a way that the appropriateness assessment does.

Providing a ‘soft’ restriction, such as an appropriate test, which does not prevent any class of investor proceeding to invest but (i) filters out those who do not understand the risks to which they are exposed, and (ii) serves to highlight the specific risks of investment ahead of time, is desirable. However, the P2PFA is concerned that the rules, as presently drafted in the proposals, are unlikely to meet this objective, and a more restrictive effect will be the consequence.

Platforms are keen to ensure that all investors have a clear understanding of the nature of the risks to which they are exposed, and to develop mechanisms to provide appropriate assurance. Likewise, preventing platforms from providing full information about the details of an individual investment offering until the appropriateness of an investor has been established is accepted as sensible.

The adoption of an appropriateness test as standard would have the effect of slowing down the investment process to enable assurance of adequate investor understanding but would not restrict access on the basis that the same process should be required of all investors. Such an approach would give the sector scope to maintain an offering for retail investors who are appropriately informed and would not exclude a significant group of prospective beneficiaries from participating in the opportunities available with lending through peer-to-peer lending platforms, including some of those who have participated to date and wish to continue doing so in the future.

Within parameters which satisfy the regulator’s concerns, platforms should be able to determine their own appropriateness test arrangements, provided that sufficient assurance from all investors is secured that the level of understanding of the nature of individual products available is robust prior to the point of making a specific investment decision.

Fundamentally, the development of peer-to-peer lending products were designed with retail investors in mind, and most platforms have devoted considerable effort in attracting the interest of this type of participant. Peer-to-peer lending is not an asset class *per se*, and platforms have done other things to address potential concerns of retail investors, including incorporating features in their products which are designed to protect and reduce or manage the exposure to certain risks.

The P2PFA believes that a regime which requires the disclosure of sufficient information about the nature of the peer-to-peer lending products available through that firm and credible material to judge the performance of that platform against its own expectations combined with an appropriateness test which assures that an investor understands the nature of their risk appetite and can align the investment opportunity with their individual propensity for risk exposure, then an investment restriction is fundamentally unnecessary.

As indicated in the Executive Summary, the P2PFA expects to work with its platforms to identify and share good practice in observing the development of appropriateness tests relevant to the business models of individual platforms and continuing the dialogue with the regulator to make sure that these are exemplars which assuage the concerns expressed in the consultation paper.

Wind-down arrangements

Question 14: Do you agree with the proposed modification to the systems and controls rules regarding wind-down arrangements? If not, please explain why.

The P2PFA requires each member to have a credible resolution plan, which exists to ensure the orderly administration of the business and run-off of its customers' contracts in the event of platform failure. There should be consistency in the regulatory approach to wind-down planning between different parts of the financial services landscape.

Question 15: Do you agree that P2P platforms must have a P2P resolution manual containing information that would assist in resolving the firm in the event of the firm's insolvency?

The requirement for a platform resolution manual to be produced seems reasonable, though ensuring that duplication with other documents – such as the Client Assets Resolution Pack and the Disaster Recovery/Business Continuity Plans – should be a priority.

Question 16: Have we correctly identified the information that should be included in the P2P resolution manual? If not, what other information should be included?

Yes, the P2PFA believes that the correct information has been identified for inclusion in the P2P resolution manual.

Question 17: Do you think additional prudential requirements are needed to provide for the availability of ring-fenced capital in the event of platform failure? To ensure that loans continue to be managed and administered during wind-down?

The P2PFA does not believe that additional prudential requirements are needed to provide for ring-fenced capital in the event of platform failure and is concerned that such an approach might harm the potential for new platforms to enter the market and damage competition. A platform which has failed is likely to be able to use elements of its operational resources in part to finance some of the costs of management and administration of its wind-down, such as those previously designated toward marketing and loan origination. This, of course, supplements the existing requirements and we do not believe that additional prudential requirements need to be stipulated across the sector.

Disclosure requirements

Question 18: Do you agree with our proposals to clarify the information that a P2P platform should provide regarding its role?

Yes. The P2PFA's response to the FCA's call-for-input focused very strongly on the importance of strengthening the regime for disclosures so as to empower consumers to make properly-informed choices about peer-to-peer lending in general and between specific platforms in particular. It is desirable that all platforms are clear with prospective investors and borrowers about the nature of the fees and charges which are applied, preferably in a consistent manner, to enable meaningful assessments to be made about the offerings available in the market.

Question 19: Do you agree with our proposals to make rules requiring a P2P platform to disclose its wind-down arrangements and to warn investors/prospective investors of the risk to their P2P agreements should the platform fail?

It is appropriate that platforms should wish to re-assure investors and prospective investors that arrangements exist to manage the continuity of the loan book in the circumstance of platform failure. It is important that arrangements for peer-to-peer lending platforms, in terms of disclosing the wind-down plans in the event of platform failure, are not more onerous or burdensome than those mandated elsewhere in financial services.

The P2PFA believes that disclosing a platform's wind-down plan would be of limited practical value to investors and prospective investors: a platform which is experiencing distress or which may be about to fail will face a number of potential options beyond those which are set out in the contents of such a document – for example, the sale of the business to a competitor; sale of the entire loan book; retention of skeleton staff whilst running the loan book to maturity; or encouraging borrowers to re-finance, where possible.

The circumstances around the failure of a platform can be considerable and varied and increasing the level of detail disclosed in advance may serve only to increase the likelihood the path taken in response to the platform's distress is not reflective of what is contained within the published plan.

Question 20: Do you agree with our proposals for additional requirements for disclosure of investment information to investors? Is there any additional information that platforms should be required to give to investors? If you disagree with our proposals, please say why.

An outline of the P2PFA's concerns regarding proposed changes to the disclosure regime was included in the Executive Summary to this consultation response.

The P2PFA supports efforts to standardise elements of the disclosure regime, and our response to Question 9 of the consultation is also relevant.

Peer-to-peer lending platforms should not be required to disclose every aspect of their business model, and the danger of an overly-prescriptive approach should be avoided. The requirements of investors should be the primary concern in considering requirements for investment information to be disclosed.

In mandating disclosure requirements, it is vital that there is a focus on transparency which is meaningful. For example, annual percentage rate (APR) disclosure would create some distortions: banks do not have to disclosure an APR in respect of business lending and, by including fees, it is not an indicative measure of credit risk. Unlike the Personal Savings Allowance (PSA) scheme, banks and building societies now pay gross interest on all savings accounts: different investors have different PSA limits and it is not appropriate for platforms to work out tax implications for each individual investor.

Question 21: Although not proposed in this CP, we invite feedback on whether it would be helpful to consumers and industry to have a standard format for P2P disclosures about the services they provide and investment opportunities?

Yes, adopting a standardised methodology for calculating and reporting on bad debt as well as loan defaults would ensure that net returns cited by platforms could be compared and assessed consistently by prospective investors. The objective should be to empower investors to make informed decisions about the various offerings provided by platforms. The P2PFA would be willing to work with the FCA in developing consistent sector-wide definitions.

Question 22: Do you agree with standardising the definition of default? If so, do you agree with the proposed definition? If not, please explain why.

The proposed definition of default (for reporting purposes) is reasonable, and the P2PFA definition of bad debt (non-performing loan) is also ninety days for all lending (other than property, which is 180 days).

There may be merit in requiring peer-to-peer lenders in the property market also to report non-performing loans after ninety days, provided that the definition of default stands at 180 days, to enable investors to make comparisons with other peer-to-peer investment propositions, should they wish, though the fundamentally different characteristics and recovery best practices in the property lending market should be acknowledged.

Question 23: Do you agree with our proposals to require disclosure of information about continency funds? If not, please explain why.

Question 24: Are there other measures that we should consider to address the harm that can arise from contingency funds obscuring underlying risks to investors, or from investors mistakenly believing a contingency fund provides a guaranteed rate of return on loans (similar to a fixed-rate savings account)?

The P2PFA has decided to answer questions 23 and 24 on contingency funds together. Some platforms have constructed their business models to include provision of a contingency fund and it is for them to explain to their investors the specifics of how such a mechanism works and in what circumstances it is available to be used. The P2PFA's Operating Principles require platforms which operate a contingency fund to make appropriate disclosures relating to its impact on returns and fund usage.

Commencement

Question 25: Do you agree with our proposal for a six-month commencement period? If not, please explain why.

The P2PFA is confident that six months would prove sufficient for most, if not all, of our members to meet the requirements of the regime proposed in the consultation paper. However, a number of firms in the sector – particularly smaller platforms and potential new entrants – may have more work to do in preparing for the requirements of the new regime, and a period of twelve months may be more suitable for all platforms across the sector.

Mortgages & Home Finance

Question 26: Do you agree with our proposal to apply MCOB 11 to platforms facilitating home finance products where one or more of the investors is not an authorised home finance provider? If not, what amendments would you suggest?

Question 27: Do you agree with our proposal to apply MCOB 13 to platforms facilitating home finance products, where one or more of the investors is not an authorised home finance provider? If not, what amendments would you suggest?

Question 28: Do you agree with our proposal to apply offer stage and post-contractual disclosure rules to platforms facilitating home finance products, where one or more of the investors is not an authorised home finance provider? If not, what amendments would you suggest?

Question 29: Do you agree with our proposed changes to pre-contractual disclosure rules for platforms facilitating home finance products, where at least one of the investors is not an authorised home finance provider? If not, what amendments do you suggest?

Question 30: Do you agree with our proposal to apply other MCOB rules to platforms facilitating home finance products, where one or more of the investors is not an authorised home finance provider? If not, what amendments do you suggest?

Question 31: Do you agree with our proposal to apply our data reporting rules to platforms facilitating home finance products, where one or more of the investors is not an authorised home finance provider? If not, what amendments do you suggest?

Question 32: Do you have any comments on the application of our other (i.e. not MCOB) rules to platforms facilitating home finance products, where one or more of the investors is not an authorised home finance provider?

The P2PFA has chosen to answers questions 26 to 31 together.

Although no member of the P2PFA currently facilitates mortgages or home finance products, the proposals are sensible and should prevent the scope for any platform to arbitrage the requirements which exist in this market.

Cost-benefit analysis

Question 33: Do you have any comments on our cost-benefit analysis for the proposals arising from the post-implementation review?

We anticipate that individual platforms are likely to spend more on elements of implementing these proposals than the estimated totals cited in the consultation paper's cost-benefit analysis. In particular, where proposals are implemented properly, then the costs are likely to be considerably more than those estimated, and the work required is expected to take longer than that assumed in the paper's cost-benefit analysis.

Question 34: Do you have any comments on our cost-benefit analysis for the P2P mortgage and home finance proposals?

No.