

Loan-based ('peer-to-peer') and investment-based crowdfunding platforms:

Feedback on our post-implementation review and proposed changes to the regulatory framework

Consultation Paper

CP18/20**

July 2018



How to respond

Consultation Paper (CP) by 27 October 2018.

You can send them to us using the form on our website at: www.fca.org.uk/cp18-20-response-form

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1 Summary

Introduction

- 1.1** The term crowdfunding is used to describe a number of ways in which people and businesses (including start-ups) raise money, typically through an internet-based platform. The platform enables those raising money to be introduced to those that want to invest. We currently regulate two ways of facilitating this¹:
- Loan-based crowdfunding – usually called peer-to-peer (P2P) lending. People and institutions use these types of platforms to lend money directly to consumers or businesses, to make a financial return from interest payments and the repayment of capital over time.
 - Investment-based crowdfunding – these are platforms where investors can invest directly in businesses by buying investments such as shares or debentures.
- 1.2** In 2016 the FCA launched a post-implementation review (PIR) of our regulation of the crowdfunding sector. This paper summarises our findings and consults on proposed new rules and guidance in areas where we believe change is required.

Structure of the Review

- 1.3** While there are some commonalities between P2P lending and investment-based crowdfunding, there are also significant differences between the two. Understanding these differences is a prerequisite to calibrating the regulatory regime appropriately. We explore the differences in the existing regulatory framework in Chapter 2, and the differences in the business models in Chapter 3, including how these differences influence the calibration of the regulatory framework.
- 1.4** Crowdfunding can be an important alternative source of finance for companies and consumers. The sector also provides an alternative investment opportunity for investors. However, investment through crowdfunding is not without risk, because of the exposure to the underlying asset that is created, and in some cases because of the complexity of the investments offered. Where such risks are not adequately managed or understood, harm to consumers and to market integrity can arise.
- 1.5** Through our PIR and ongoing work in Supervision and Authorisations, we have observed some poor business practices that we believe cause actual or potential harm. We explore this in Chapter 4, including why some of the practices we have observed have led us to conclude that our regulatory framework needs updating and further rules and guidance are required. In Chapter 5 we explain our proposed new requirements in more detail.

¹ We do not regulate other forms of crowdfunding, such as reward or donations based crowdfunding, unless they involve regulated activities such as payment services.



- 1.6** The proposals in this CP seek to prevent harm to investors, but to do so in a proportionate manner that continues to permit innovation. This should help both fundraisers and investors to enjoy the full benefits of a well-run P2P sector in the long term.
- 1.7** We are also proposing to create new protections for borrowers. See paragraphs 1.37 and 1.38, and Chapter 7 for more information.

Evolution of the industry

- 1.8** Investment-based crowdfunding business models tend to be relatively simple. These platforms act as a conduit, giving investors a route to see and assess information about underlying investment opportunities. Investors choose what they want to invest in, and typically purchase a security.
- 1.9** In contrast, the P2P sector has always been diverse but P2P platforms have developed a wider, more complex, range of business models, with many now taking a much more active role, by taking decisions on behalf of the investor.
- 1.10** For example, some platforms not only facilitate lending but actively structure which loans investors are exposed to in order to achieve a target rate of return. As a result, their offering is also marketed differently, with a focus on headline rates. These platforms provide financial services that often require sophisticated risk management. A P2P platform may also facilitate a loan to a borrower, by splitting the loan across a number of investors (lenders). This means multiple bilateral contracts (called P2P agreements²) underpin one loan. As a result, an investor may only be exposed to relatively small individual amounts, making administration of the contract on a standalone basis potentially impractical or economically unviable. The ongoing performance of the platform thus becomes critical to the outcomes experienced by the investor.

How business model diversity impacts investors

- 1.11** While a segmentation of the crowdfunding sector into investment-based crowdfunding and P2P lending aids an understanding of the sector, a more granular breakdown of the services offered by the different platforms is required to understand the potential for harm to investors.
- 1.12** The crowdfunding industry arranges funding for a wide range of underlying businesses or persons. The potential for harm is influenced by what kind of underlying financing the platform facilitates, as the investors will be exposed to very different types of investment risk depending on exactly what is being offered. For example, in the P2P sector, investment risk will vary depending on whether an investor is exposed to consumer loans or to loans financing property purchase or development projects.
- 1.13** Investment risk also varies depending on the type of the investment (for example, in the investment-based sector, whether investors are buying shares or bonds). Harm

² www.handbook.fca.org.uk/handbook/glossary/?starts-with=P

may arise when investors do not understand the risks they are exposed to, or if the resulting financial exposure is unsuitable.

- 1.14** We explore the differences in business models and the risks arising from them in Chapter 3.

Terms used

- 1.15** For simplicity, throughout this document we use the term 'investors' when referring to those investing in both investment-based crowdfunding and P2P. It is important to recognise that P2P investors are lenders under bilateral loan agreements, ie each investor has an individual contract to provide credit to each borrower. They are entering into a contractual relationship with the underlying borrower, and the platform is providing a service in relation to this contract, usually to both parties.
- 1.16** In addition, throughout this document we refer to the authorised firm operating the crowdfunding platform as a 'platform' rather than as a 'firm'.

Potential and actual harms

- 1.17** In addition to observing a range of business models, we have also seen some poor business practices, particularly among some P2P platforms. For example, in relation to disclosure of information to clients, charging structures, wind-down arrangements and record keeping.
- 1.18** In some cases, the underlying drivers of harm arise because of poor business practice, and in some cases because of the risks arising from the business models of some platforms in the sector.
- 1.19** Our review of the sector has identified a number of potential and actual harms that may impact investors, including:
- confidence and participation threatened by unacceptable conduct such as unreliable performance or by disorderly failure
 - buying unsuitable products
 - poor customer treatment
 - price too high or quality too low
- 1.20** These are particularly relevant to the FCA's operational objective of consumer protection.
- 1.21** In practice, this means investors may not:
- be given clear or accurate information, leading to the purchase of unsuitable financial products



- understand or be aware of the true investment risk they are exposed to
- be remunerated fairly for the risks they are taking
- understand what may happen if the platform administering their loan fails
- understand the costs they are paying for the services the platform provides, or
- may pay excessive costs for a platform's services

1.22 We explore the types of harm further in Chapter 4.

Investor protections – existing regulatory framework and overview of proposed changes

1.23 All crowdfunding platforms are subject to our general high level standards including the Principles for Businesses, and specific Conduct of Business rules, for example, in relation to financial promotions. However, there are differences in the detailed regulatory framework that applies to investment-based crowdfunding platforms and P2P platforms, which we explain further below.

Investment-based crowdfunding platforms

1.24 Investment-based crowdfunding has evolved from more traditional ways of offering securities and investments, and the regime applicable to these platforms offering this service reflects this.

1.25 Detailed regulatory obligations require investment-based crowdfunding platforms to manage the risk of investment business (platforms are typically subject to requirements stemming from the Markets in Financial Instruments Directive II (MiFID) or the Alternative Investment Fund Managers Directive (AIFMD), with exact requirements depending on the type of business conducted, and related provisions in our Handbook).

1.26 We are largely content that the regulatory framework in place for investment-based crowdfunding platforms is adequate. But, as part of our explorations of the different types of harm, in Chapter 4 we provide some clarifications where we consider poor compliance with existing rules can give rise to actual or potential harm. Where non-compliance is observed, as is usual practice, we consider what action is appropriate and contact the relevant firm(s) as necessary.

P2P platforms and proposed rules

1.27 P2P platforms came within the FCA's regulatory perimeter more recently, in 2014.

1.28 The current regulatory framework applicable to P2P lenders is a domestic regime and is less detailed and prescriptive. It was designed at its introduction as a proportionate framework to give investors appropriate protection without preventing innovation and growth. The market at that time was diverse, new and growing. The design of the regime also reflected that the market had the potential to improve competition by offering alternative sources of finance for individuals and businesses. We committed at the time to conducting a PIR.

- 1.29** In light of the complexity of some of the business models we have observed as part of the PIR and the resulting risk of actual and potential harm, we propose in this consultation a package of additional rules and guidance, aimed at formalising requirements and improving standards in the sector, without hindering the possibility of further innovation.
- 1.30** To ensure investors are given clearer information about investments, charges and risk, we propose to set out the minimum information that P2P platforms need to provide to investors. We expect that many platforms already provide much of this under existing financial promotions and disclosure rules, but where they do not, improvements will be required to meet existing and proposed standards.
- 1.31** When a platform advertises a target rate of return, we want that target rate to be achievable, and for investors to understand and be fairly remunerated for the risks they are exposed to. Where P2P platforms price loans or choose loans on behalf of investors, the platform needs to have a good understanding of the credit risk associated with any loan. Investors are exposed not only to the performance of the underlying loan, but also to how well the platform prices these loans or manages the selection and monitoring of their portfolio. For that reason, we are proposing more explicit requirements to clarify what systems and controls platforms need to have in place to support the outcomes they advertise. These new rules focus particularly on credit risk assessment, risk management and fair valuation practices.
- 1.32** While we have seen poor practices in parts of the sector, other P2P platforms already have more robust systems and controls in place. Those platforms will need to make fewer changes to comply with the more detailed requirements we propose. However, for some platforms, significant improvements to systems and controls will be required to meet existing and proposed standards.
- 1.33** We propose to strengthen rules on plans for the wind down of P2P platforms. This includes proposals to ensure arrangements are in place that take account of the practical challenges that platforms could face in a wind-down scenario; for example, in relation to the continued functioning of the complex IT infrastructure underpinning the business models of some P2P platforms.
- 1.34** There is a risk of harm when investors are exposed to potentially unsuitable, risky assets. To reduce this risk, we propose to extend marketing restrictions that already apply to investment-based crowdfunding to P2P platforms.
- 1.35** So far, losses and defaults across the P2P sector have been low. However, it is important to recognise that the sector is still relatively new and has not been through a full economic cycle. When economic conditions tighten, losses on loans and investments may increase. The sector has not yet been through such a tightening and so the resilience of the P2P business models observed remain relatively untested.
- 1.36** We want our rules to be appropriate for the diverse and complex P2P business models that have emerged. In particular, our rules in relation to risk management, governance and wind-down plans are designed to be flexible and proportionate to the scale and complexity of different businesses. More complex platforms will require more sophisticated controls and platforms can choose to enhance their controls as necessary, or simplify their business model.



Borrower protections – existing regulatory framework and proposed changes

- 1.37** P2P platforms provide a service to investors and much of our consultation focuses on this. However, the proposals in this CP must be read alongside our existing rules aimed at protecting borrowers, in our Consumer Credit sourcebook (CONC). These include rules requiring P2P platforms to assess the borrower's creditworthiness, including affordability; parallel requirements apply to lenders acting by way of business.³
- 1.38** In Chapter 7 of this CP, we set out proposals to apply Mortgage and Home Finance: Conduct of Business sourcebook (MCOB) and other Handbook requirements to P2P platforms that offer home finance products, where at least one of the investors is not an authorised home finance provider. This aims to address a potential gap in protections for home finance customers who undertake transactions through a P2P platform.

Outcome we are seeking

- 1.39** Our proposals aims to create an environment where:
- investors:
 - have the necessary information about a platform's services and charges to help them make informed decisions
 - have clear and accurate information about the investment risk of a product to make suitable investment choices in line with their risk tolerance
 - are appropriately rewarded for the risks they are taking
 - understand that their capital is at risk and they may suffer losses
 - home finance customers:
 - have a similar level of protection to that they would have if the provider were authorised
 - and platforms:
 - are well-governed and compete effectively for business
 - structure their business in a way that aligns their fees, charges and profits with the principle of treating customers fairly
 - carry out risk assessment and pricing of underlying assets to a high standard
 - have appropriate arrangements in place to ensure that P2P agreements continue to be administered if the platform ceases to operate for any reason

³ The CONC creditworthiness rules apply to P2P agreements where the borrower is an individual, including a small partnership or unincorporated body which does not consist entirely of bodies corporate and is not a partnership, unless (in the case of business borrowing) the amount of credit under the individual agreement exceeds £25,000.

Who this applies to

1.40 This CP will be of particular interest to the following groups:

- P2P platforms
- investment-based crowdfunding platforms, and other firms offering non-readily realisable securities
- trade bodies for these sectors
- consumers and businesses investing or considering investing through an online crowdfunding platform or in non-readily realisable securities more broadly
- consumers and businesses that have entered, or plan to enter, into loan agreements as borrowers via P2P platforms
- intermediaries who might refer home finance customers to P2P platforms
- consumer organisations who might also like to consider the proposals

Measuring success

1.41 Should the proposed rules be finalised, through our supervision work we will look for:

- visible improvements to financial promotions and marketing materials
- clearer and more meaningful data for investors on the range and performance of investments offered
- better quality of governance and oversight of both the platform and the system for risk rating and managing a portfolio(s) of loans
- platforms' systems and controls to manage conflicts of interest
- platforms to demonstrate that they are pricing loans fairly, and
- that consumers will receive a fairer risk/reward trade-off

Equality and diversity considerations

1.42 Crowdfunding platforms may carry particular risks for some groups with protected characteristics under the Equality Act 2010:

- Our Financial Lives Survey 2017⁴, indicated that individuals who rely on pensions and who do not have much disposable income may be more likely to have significant sums in savings and, as a result, be concerned about low interest rates on savings

⁴ www.fca.org.uk/publication/research/financial-lives-survey-2017.pdf



and be looking for higher yield elsewhere. This may lead them to invest significant amounts on crowdfunding platforms, potentially taking inappropriate levels of risk with their money.

- The web-based and social-networking nature of crowdfunding could also pose a risk to young, inexperienced investors who may be attracted to the concept without fully understanding the risks.

1.43 In developing our proposals, we have sought to reduce these risks by proposing rules that require P2P platforms to give clearer information and risk warnings to investors, and that introduce marketing restrictions. We have also targeted specific features of business models that may cause harm.

1.44 There is currently no UK P2P market for regulated home finance. We are making proposals to address a potential gap in the protections for home finance customers if such a market were to develop. We do not anticipate that these proposals will disproportionately impact people with particular protected characteristics.

1.45 We welcome any feedback from consultation respondents on the impact of all of our proposals on groups with particular protected characteristics.

Q1: Do you have any comments on our assessment of the equality and diversity considerations?

Next steps

1.46 We will continue to engage stakeholders during the consultation period. After this we will review and analyse all responses and consider if any changes to our proposals are needed as a result. We will then publish final rules in due course, along with details of when these will come into force.

2 The wider context

Evolution of the regulatory landscape

- 2.1** The regulatory landscape governing crowdfunding has evolved over time.
- 2.2** **Investment-based crowdfunding**
Investment-based crowdfunding has developed from more traditional ways of raising finance for companies and other types of investment business. Platforms are regulated in a number of ways depending on the activities undertaken by each specific platform. Most platforms either hold permissions related to MiFID business or under the AIFMD. As such, comprehensive regulatory regimes have been applicable to these platforms for some time.
- 2.3** There have been relatively few changes to the domestic framework applicable to investment-based crowdfunding, though in 2014 we imposed marketing restrictions to limit the promotion of unlisted securities to certain types of investor.
- 2.4** **Loan-based crowdfunding or P2P**
Regulation of P2P platforms has developed more recently. Before 2014, P2P platforms were typically licensed by the Office of Fair Trading (OFT) for activities such as debt administration. On 1 April 2014, the regulated activity of 'operating an electronic system in relation to lending', specified in article 36H of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, came into force. This was a new regulated activity specifically designed to apply to P2P platforms under the responsibility of the FCA.
- 2.5** At the same time responsibility for consumer credit regulation transferred from the OFT to the FCA.
- 2.6** At the point of transfer, firms which already held an appropriate OFT licence were able to register for interim permission for the new regulated activity. Having an interim permission allowed these firms to remain in the market pending full authorisation. Firms with interim permissions are subject to the same rules as authorised firms, and our power to supervise and enforce against breaches apply equally to both. Firms with an interim permission need to satisfy the threshold conditions before being authorised.
- 2.7** The Regulated Activities Order has been amended several times since 2014, with the effect being greater flexibility for P2P platforms to structure their businesses differently within this overall regulated activity.
- 2.8** The original regime reflected that the P2P crowdfunding market was relatively new. We also believed that the market had the potential to improve competition by offering alternative sources of finance for individuals and businesses.



- 2.9** The regime currently applicable to P2P platforms is based primarily on our general Systems and Controls (SYSC) rules, Conduct of Business (COBS) rules and our Principles for Businesses, though there are a number of specific requirements:
- minimum prudential requirements that platforms must meet to ensure ongoing viability
 - a requirement to take reasonable steps to ensure existing loans continue to be managed in the event of platform failure
 - rules that platforms must follow when holding client money to minimise the risk of loss due to fraud, misuse, or poor record keeping and to provide for the return of client money in the event of platform failure, and
 - reporting requirements for platforms to send information to the FCA in relation to their financial position, client money holdings, complaints and loans they have arranged
- 2.10** Our Consumer Credit sourcebook (CONC) also has requirements that apply to P2P platforms that aim to protect borrowers on the platforms. In July 2017, we consulted on proposed changes to the CONC rules on creditworthiness assessment in consumer credit, including for P2P agreements.⁵ We aim to publish a policy statement with final rules and guidance shortly.
- 2.11** Whilst a specific domestic regulated activity was created in relation to P2P lending, depending on how it structures its business a platform facilitating loan contracts could also be subject to other regulatory requirements, including for example under the AIFMD if it manages a collective investment undertaking. This CP focuses on P2P platform activities within the domestic regulated activity.
- 2.12** Finally, in October 2017 we published 'Reviewing the funding of the Financial Services and Compensation Scheme (FSCS): feedback from CP16/42, final rules, and new proposals for consultation' (CP17/36). In that publication, we confirmed that we do not consider it is justifiable to bring P2P lending under the FSCS scheme. This means that investors are not protected by the FSCS should the P2P platform they are using go out of business, and this lead to losses, for example loans not being re-paid in full or at all. In light of our PIR findings about the complexity of the business models and potential for harm relating to consumer losses that could arise in case of the failure of a P2P platform, we intend to keep the matter of FSCS coverage for the sector under review but are not consulting on further changes at this point.

Post-implementation review (PIR)

- 2.13** Reflecting the fact that we expected the P2P sector to grow and develop, when we introduced the rules applicable to these platforms in 2014, we said we would conduct an interim review of the rules after one year and a full PIR in 2016. As part of that review we published a Call for Input in July 2016.⁶

⁵ CP17/27 *Assessing creditworthiness in consumer credit: Proposed changes to our rules and guidance* (July 2017).
www.fca.org.uk/publication/consultation/cp17-27.pdf

⁶ *Call for input to the post-implementation review of the FCA's crowdfunding rules* (July 2016):
www.fca.org.uk/publication/call-for-input/call-input-crowdfunding-rules.pdf

- 2.14** We followed this with an Interim Feedback Statement in December 2016⁷, which summarised some of our initial findings and concerns about the sector. These included inadequate disclosure of relevant information to consumers, and platforms testing the boundaries of the regulated crowdfunding perimeter, introducing the risk of arbitrage with investment management or banking activities. We did not identify specific changes as necessary at that point but said we wanted to keep this under review for the full PIR and that we would consult on new rules to strengthen investor protections.
- 2.15** The next stage of the PIR process has taken longer than we originally expected. This is because our review has been wide in scope, taking into account the diversity and complexity of business models now present in the sector when considering the potential for harm and the case for intervening. It also reflects that, as we expected, the sector has evolved rapidly and we have continued to consider new developments as they have happened.

Recent developments

- 2.16** The European Commission has recently published proposals for crowdfunding⁸, to make it easier for platforms to offer their services across the EU and improve access to this source of finance for businesses in need of funding.
- 2.17** We will continue to engage with European and international regulators to ensure our regulatory framework is appropriately balanced and reflects insights into risks of harm gained in other jurisdictions.
- 2.18** Industry bodies have also published operating principles that their members have to adhere to. In particular, in December the Peer to Peer Finance Association announced new operating principles. These have applied to members since April 2018. We will continue to work closely with platforms and trade associations when refining the proposals in this CP, as well as other interested stakeholders.

7 *Interim feedback to the Call for Input to the post-implementation review of the FCA's crowdfunding rules, December 2016:* www.fca.org.uk/publication/feedback/fs16-13.pdf.

8 https://ec.europa.eu/info/publications/180308-proposal-crowdfunding_en



3 Findings of the PIR: Crowdfunding business models

Overview

- 3.1** In this chapter, we explore the different crowdfunding business models, their respective degrees of complexity, and their inherent risk. We describe these in detail to share our findings from the PIR, and because an understanding of the variations in business models and services offered is required to understand the discussion of poor business practices and related harms set out in subsequent chapters.
- 3.2** In general, investment-based crowdfunding business models tend to be relatively simple. Platforms act predominantly as conduits, providing investors with an online route to see and assess information about underlying investment opportunities. Investors choose what they want to invest in.
- 3.3** P2P platforms tend to be more complex. They not only facilitate lending but typically price loans and often manage investors' portfolios to achieve a target return. These platforms provide a much more structured financial service and operate complex business models that require sophisticated risk management and controls.
- 3.4** However, splitting the crowdfunding sector just into P2P and investment-based crowdfunding would be too simplistic given the diversity of business models and underlying assets. In this chapter, we thus break down different models based on features of the offering they provide, rather than distinguishing between the type of crowdfunding undertaken.
- 3.5** The potential for harm to occur stems in part directly from the features of the different business models:
- The inherent complexity in some models creates greater potential for harm to investors. Whether actual harm occurs depends on platforms' ability to manage this complexity.
 - Platforms with different models advertise their offering in different ways. This in turn impacts how the investor perceives the role of the platform. Harm may occur when there is a mismatch of expectations between what an investor thinks they are getting, and what they are actually getting in practice. The risk of this is greater for certain business models.
 - The additional services some platforms offer have the potential to compound the potential for harm. These services, described further below, can make it harder for investors to understand the true nature and scale of the risks they are taking.
- 3.6** In addition, the type of investment a platform facilitates (ie what type of company, project or individual borrower will an investor be exposed to) impacts the possibility of loss occurring. For example, the risk profile of an individual borrowing money

is very different to that of a business, or to a loan being used to finance property development. In the context of loans the platform's ability to predict the probability of losses with a degree of accuracy will vary depending on the type of loan.

- 3.7** The risk of losing money as a result of a high-risk investment is not itself a cause of harm. However, the more complex the business model, the greater the potential for harm to arise. For example, where a P2P platform advertises a target rate but has an underlying portfolio with a return profile that is hard to model, the systems and controls required to manage such risks need to be significantly more sophisticated. In this example, there is a risk of harm if a platform does not have adequate systems and controls in place. Exposure to high risk is fine for those who understand and accept the risk.
- 3.8** Our observations about business models come from the PIR and our authorisations and supervision experiences.

Core business models

- 3.9** As already highlighted, there is a diverse range of business models now operating in the sector. For the purposes of this CP, we have grouped platforms into three main categories, referred to in this paper as the following:

Model	Features
Conduit platforms	The investor picks the investment opportunities and the platform administers the loan or investment arrangements
Pricing platforms	The platform sets the price, but the investor picks the underlying loan or investment
Discretionary platforms	The platform sets the price and chooses the investor's portfolio of loans to generate a target rate – this is only seen in the P2P sector

- 3.10** The three platform types are not exclusive or exhaustive, we are using these three broad categories to help us explain our findings. A single platform can operate in more than one way (for example, adopting a different model for different categories of client).
- 3.11** In the case of P2P platforms, all three models administer loan arrangements, and we have observed that platforms that allocate loans to investors are also inevitably involved in pricing these. This is illustrated in Table 1 Summary of main business models, on page 19.

Conduit platforms: investor picks underlying loans or securities

- 3.12** Platforms with this business model provide a vehicle for investors to view and assess information about an underlying investment opportunity, be that a security or a loan. Primarily they act as a conduit. The investor chooses the underlying investment directly. So the role of the platform is focused on:

- i. advertising investment opportunities to investors, without being involved in setting the price of these investments or loans (which is negotiated directly between the borrower and the investor). Investors make an investment decision, based on the



information available. We understand that in most cases investors spread their investment across multiple loans or investments, rather than choosing to invest in a single investment, but this choice is left up to the investor

- ii. carrying out due diligence of potential investment opportunities (the platform will do this inter alia so that it has a reasonable basis on which to comply with Principle 2⁹ (PRIN 2.1.1R) and the client's best interests rule¹⁰ (COBS 2.1.1R)) in our conduct of business rules, and
- iii. administering the investments or, in the case of a P2P platform, loans the platform has facilitated

3.13 We have found this to be the prevalent business model in investment-based crowdfunding. Some P2P platforms also operate this model, though this is rare as most P2P platforms appear to have a role in pricing loans.

3.14 We have found that P2P platforms are more likely to operate one or both of the following models.

Pricing platforms: the platform itself sets the price, but the investor picks underlying loans

3.15 This model is similar to the Conduit platform, in that the investor chooses the underlying investment directly, but the platform sets the price of the loan or security it advertises. For example, in the case of a P2P platform, it sets the interest rate the borrower must pay for a loan and the rate to be received by the investor. As with the Conduit platform, the investor makes their investment choice based on the information given on the platform. We have predominantly observed this model within the P2P sector.

Discretionary platforms: the platform sets the price and chooses the investor's portfolio to generate a target rate

3.16 The Discretionary platform is the most complex business model that we have found through our PIR. We have only seen this business model within the P2P sector, where it has become the prevalent business model. In this model, the platform advertises the ability to invest through the platform, typically highlighting a target rate of return to the investor. The investor does not typically know who they are lending to, and in any case cannot choose who to lend to, or refuse to lend to, within the pool of borrowers the platform chooses.

3.17 These platforms set the price of loans and advertise a target rate of return.

3.18 In practice, the platform offers each investor a blended target rate of return that it seeks to achieve by investing that investor's capital in a tailored portfolio of loans. The rate is 'blended' because the actual interest received by the investor is made up of the interest being paid across a number of different loans allocated to that investor, each with potentially different underlying rates being paid by the borrowers. The platform's aim is to 'blend' these effectively so that the investor receives what was advertised to them (in this CP, we refer to this as the 'target rate').

9 A firm must conduct its business with due skill, care and diligence.

10 A firm must act honestly, fairly and professionally in accordance with the best interests of its clients.

- 3.19** The platform effectively acts akin to a discretionary manager for the investor as it selects the loans that an investor is exposed to. Some, but not all, platforms give the investor a choice of what level of risk they wish to be exposed to. Platforms will typically have an automated process for selecting loans in line with any risk criteria built into their algorithms.
- 3.20** Whilst individual loan contracts underpin the investor's exposure, the investor may perceive the offering as more akin to a structured or savings product.
- 3.21** If the platform manages a portfolio well, it may achieve a better risk/return trade-off than an investor would achieve if they picked the investments themselves. However, if risk management is inadequate or fails, this could have a material impact on the return to the investor irrespective of the performance of the underlying loans.
- 3.22** Some platforms invest an investor's money in loans once it is received (or fairly soon thereafter), and the investor remains invested in those loans until the loans reach maturity. Other platforms adjust an investor's portfolio of loans over time, for example replacing loans that have matured with new loans. In this case, the platform also determines the price at which a loan is transferred in or out of the investor's portfolio.

Ancillary services

- 3.23** In addition to the core business of facilitating finance, platforms provide investors with a range of ancillary services, either directly or through a related entity. Some of these services are crucial to administering the actual investment, so whilst they are ancillary to the core facilitation of finance they are a prerequisite for the platform's offering to function as intended.

Nominee or agent

- 3.24** An investment-based crowdfunding platform, or a related company, might act as nominee for the investor in relation to the securities they invest in. In this capacity, some platforms exercise rights such as voting rights on behalf of the investor. The platform may receive periodic updates from the investee company to be able to do this. The choices a platform makes can be crucial to the investment outcomes an investor achieves. For example, a platform could be consenting to a dilutive, non-pre-emptive further issue of shares on behalf of investors.

- 3.25** In P2P models, the platform might act as the investor's agent in relation to the underlying loan portfolio(s), and be able to take certain action on behalf of the investor and/or borrower, depending on the specific contractual terms entered into. For example, they may be able to reassign loans, and in this way revise an investor's portfolio.

Security and investor interdependencies in P2P

- 3.26** Some P2P platforms facilitate loans that are backed by an asset. For example, a loan could be secured against land or property.
- 3.27** Usually the platform or a company within the same group will be nominated to act on behalf of a group of investors in relation to such security. For example, this avoids multiple single investors having to pursue action against the borrower in case of default.



Contingency funds in P2P

- 3.28** Some P2P platforms offer contingency funds (sometimes referred to as provision funds), designed to top up payments made to investors if a borrower defaults.
- 3.29** These funds are intended to offer an additional level of protection from losses, but they can create a false sense of security. They can lead investors to believe that platforms are providing a guaranteed rate of return on the loans they facilitate (similar to a fixed rate savings account).
- 3.30** We have observed that the contingency fund may be funded by borrowers, investors or in some cases using the platform's own money (including money the platform would otherwise take as profit if no default occurs). We also have concerns about the operation, disclosure and resilience of these funds.
- ### Internally managed secondary market
- 3.31** Some crowdfunding platforms operate secondary markets to allow investors the possibility of exiting their investments or loans early.
- 3.32** Investment-based platforms may offer a facility that receives, pools, aggregates and broadcasts indications of interest (ie a Bulletin Board).¹¹
- 3.33** To reduce the risk of information asymmetries being exploited where the selling or buying investor knows more about the investment than the other party, platforms typically choose to suspend such bulletin boards at times, for example when they have received information about the financial performance of the business that might affect the valuation. Some investment-based platforms provide more extensive secondary market facilities and are authorised as Multilateral Trading Facilities.
- 3.34** P2P platforms can also operate a secondary market akin to a Bulletin Board, but typically the P2P platform takes a more active role in the operation of such a market.¹² For example, an investor may not be allowed to choose which loans to sell, but will indicate what monetary amount they wish to sell. The platform then decides which loans to try to sell, up to this stated amount. Again, much of this is automated via proprietary software, and the platform will 're-paper' the loan contract.

11 If the arrangements of a platform have the characteristics of a multilateral system, such a platform will be required, under MIFID, to have trading venue permissions (see MAR 5AA.1).

12 P2P platforms have more flexibility on how to manage a secondary market without triggering further regulatory requirements as this does not normally involve a MIFID instrument.

Table 1 Summary of main business models

Model	Predominant Platform Type	Features and implicit expectations	Additional Services
Conduit	P2P	Platform undertakes due diligence on person/business seeking investment and decides whether to offer them on the platform	Investor independencies, for example through common security Contingency funds Different types of secondary markets Other ancillary services
	and Investment-based	+ Investor is <u>responsible</u> for choices made about the prospect of a good return on individual loans/investments	
Pricing	P2P	Platform undertakes due diligence on person/business seeking investment and decides whether to offer them on the platform	
		+ Platform is responsible for accurately pricing loan (ie calculates the contractual return for an individual loan) + Investor is responsible for choices made from the platform's <u>advertised interest rates</u> for individual loans	
Discretionary	P2P	Platform undertakes due diligence on person/business seeking investment and decides whether to offer them on the platform	
		+ Platform is responsible for accurately pricing loan (ie calculates the target rate of return across a portfolio of loans) + Investor chooses from platform's <u>advertised target rates of return</u> + Platform allocates investment on behalf of investor to achieve advertised target rate of return	

How different business models contribute to perceptions, and resulting potential for harm

3.35 The different business models have the potential to create different expectations from the perspective of the investor, not least because of how the investment outcomes are marketed. As explained above, in the Conduit and Pricing models, the underlying investment is marketed, and in the Discretionary model the focus is typically on a target rate of return over a given time horizon.

3.36 Given this different focus, we believe that when using the services of Conduit or Pricing platforms it is more likely that the investor will comprehend that their possible return is linked to the underlying investment or loan they have chosen. The investor may still not



understand the true underlying investment risk and return characteristics, and their ability to do so will depend on the accuracy and completeness of the information the platform provides, as well as the investor's level of knowledge or experience.

- 3.37** By contrast, when using the services of a Discretionary platform, the investor may be left with the impression that the investment return is linked to and actively managed by the platform. Of course, the performance of the underlying asset is still relevant, but to a certain extent this investor perception would be correct. The ability to achieve the target rate of return is greatly affected by the platform's ability to select an appropriate portfolio of loans. This includes the platform's ability to assess the risk and return profile, likelihood of default and loss and, in some cases, to manage this effectively over time. In this context, we are of the view that the platform has a responsibility to the investor that goes beyond disclosure of information. The platform also needs to have a risk management framework that allows it to determine whether the advertised return can be achieved. Our proposed rules seek to strengthen this requirement, as explained further in Chapter 5.
- 3.38** Even if the platform provides extensive information about the type of underlying loans, the investor cannot reasonably be expected to assess the platform's ability to manage these effectively. However, with more and better information investors might be able to compare the relative performance of different platforms, or an individual platform's ability to achieve the returns it predicts and their track record of doing so over time.
- 3.39** A mismatch of expectations created and actual services offered can cause harm to investors. Platforms thus need to take responsibility for meeting the expectations they create, and the proposed regulatory framework is designed to reinforce this.
- 3.40** The risk that investors believe their investment or capital is guaranteed is particularly concerning for investors who are less able to bear losses should they occur. For example, survey evidence suggests that over 9% of funds lent through P2P platforms are the redirected retirement savings of individuals who are at or approaching retirement age. According to the 4th UK Alternative Finance Industry Report published by the Cambridge Centre for Alternative Finance, 39% of investors view these funds as money towards retirement saving.¹³
- 3.41** What taking responsibility for meeting expectation means in practice will vary depending on, and is linked to, the business model a firm chooses to operate. Our proposed rules reflect that firms have choices in this regard.
- 3.42** Each business model will create different expectations in the eye of the investor which may or may not be realistic. The investor's understanding of return and the level of risk is therefore an important measure of harm, and explains our different regulatory expectations of a platform's responsibility dependent on the business model. But these differences also exist in other interactions with the investor. We explore this further in the context of the explanation of harms in the next chapter. Our proposals for consultation reflect that we have different expectations for different business models and offerings, and aim to be proportionate to the nature of the underlying business model and its complexity.

13 www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2017-12-21-ccaf-entrenching-innov.pdf

Relevance of the underlying asset to the potential for harm

- 3.43** Crowdfunding platforms facilitate finance to a wide range of companies and persons.
- 3.44** In investment-based crowdfunding, we predominantly observe investments in small and medium-sized enterprises (SMEs), microcaps and start-ups, though some platforms provide finance for properties or green infrastructure projects. Finance is predominantly through equity investment, though some platforms facilitate investment in debt securities.
- 3.45** In the P2P sector, a variety of loans are facilitated. SME finance, consumer credit and property finance (including property development finance) are prevalent categories. A significant proportion of consumer finance is unsecured and for consumables. Loans can vary in length, and repayment schedule, such as with 'bullet' (where a large part of the loan is repaid in a single payment, normally near the end of the term) or amortising structures (where payments of capital are spread over the life of the loan).
- 3.46** The risk and return profile the investor is exposed to varies enormously depending on the type of underlying investment or loan.
- 3.47** The difficulty of predicting and valuing risk and return will also vary according to the type of underlying asset. In the prevalent P2P model, in which the platform advertises a target rate, a platform's risk management system (including credit analysis and valuation methodologies) thus needs to be tailored to take account of the specific challenges associated with evaluating the particular type of loans the platform facilitates. Again, our proposed regulatory framework recognises a firm should have systems that are appropriate for the kind of underlying business they facilitate, as explained further in Chapter 5.

Q2: Do you have any comments on the description of the business models in this section?



4 Findings of the PIR: Types of harm

Overview

- 4.1** Through our PIR, as well as through information gathered as a result of our authorisations and supervision work, we have observed some poor business practices in the industry. These give rise to potential and actual harm.
- 4.2** We provide an overview of the poor business practices observed in this chapter. We also explain how the risk of harm varies depending on the underlying business model, with references to the categorisation explained in Chapter 3.
- 4.3** In summary, we have identified that investors in P2P crowdfunding may not:
- be given clear or accurate information, leading to the purchase of unsuitable financial products
 - understand or be aware of the true investment risk they are exposed to
 - be remunerated fairly for the risks they are taking
 - understand what might happen if the P2P platform administering their loan(s) fails
 - understand the costs they are paying for the services the platform provides, or
 - may pay excessive costs for a platform's services
- 4.4** A combination of these factors may lead to reduced confidence in crowdfunding and harmful side-effects if the failure of one platform leads to a loss of confidence in other platforms, or the sector as a whole.
- 4.5** Where poor practice exists in complex business models the potential for harm is compounded. For example, if a platform operates a complex business model but does not have the systems and controls in place to support it, the likelihood of this leading to harm to the platform's investors is much higher. In part because of complex business models in the P2P sector, we observe a particular risk of harm in relation to some P2P platforms.
- 4.6** In some instances, firms need to improve adherence to the existing regulatory framework. In other areas, we believe additional rules and guidance to clarify or supplement the existing regulatory framework will also help reduce harm. We explore the case for change in this chapter. The proposed changes to the handbook are then explained in detail in Chapter 5.
- 4.7** When actual harm is observed we have four main objectives:

- To stop that harm as quickly and proportionately as possible, for example by preventing firms selling inappropriate products to customers, especially if those customers are vulnerable
- To ensure firms have put things right (including redressing customers affected)
- To address the root causes of potential harm, for example, requiring firms to remedy poor systems and controls
- To hold the firm and/or individuals in the firm to account as appropriate where there has been misconduct. This could involve enforcement action

4.8 Our responses are tailored to the harm we see and we may respond with more than one remedy and act across a number of firms at once.

Poor communication and marketing material

Inadequate explanation of risks

4.9 Our review has shown that platforms do not always communicate to investors the true nature and risk of the investment they will be exposed to. We have observed this in relation to both investment-based crowdfunding and P2P platforms, but our concerns are heightened in relation to P2P platforms.

4.10 Some examples of poor practice that we have seen across the crowdfunding sector include:

- failure to include a prominent investment risk warning meaning risks of investing can be easily overlooked by investors
- advertisements emphasising the positive nature of investments while failing to balance this with appropriate explanation of risks
- platforms creating a sense of scarcity that might encourage investors to act impulsively due to the impression that they might otherwise miss the opportunity

4.11 In addition, some examples we have seen in the P2P sector include:

- past performance is included in advertisements, but without a clear warning that this does not indicate likely future performance
- in relation to platforms that offer a target rate of return, maximum target rates of return being advertised in a way that investors might easily mistake for fixed returns
- failure to clearly state that investments are not covered by the Financial Services Compensation Scheme (FSCS)

4.12 We consider these practices can lead to harm as investors do not receive accurate or complete information on which to base their investment decisions, and may choose inappropriate products as result.



4.13 All platforms are already required to ensure their communications are fair, clear and not misleading and are required to explain to investors the nature and risk of the investment. There is also specific guidance for P2P platforms which sets out examples of the information a platform should provide. We want to make our expectations of what this means in practice for P2P platforms even clearer. We are, therefore, consulting on a range of proposals which aim to improve disclosure of the services provided by P2P platforms, the investments they offer and the risks they pose. See Chapter 5 paragraphs 5.65 to 5.86 which explain our specific proposals.

Platforms do not provide sufficient information and do not have adequate systems and controls to support good disclosures to investors

- 4.14** Across all types of platforms, we have found that some platforms are not giving investors enough information to make an informed investment decision. In some cases, this may be because the platform itself may not have the necessary information, due to the complexity of the system of loans being operated.
- 4.15** To provide the correct disclosures to investors, all types of platform need to gather information about the underlying investments and loans they facilitate. Platforms need to have the right systems and controls to gather this information.
- 4.16** What constitutes adequate provision of information depends on the business model a platform operates, more so than whether it is an investment based platform or a P2P platform. What systems and controls the platform needs to support the disclosures also varies according to business model and the type of underlying investment facilitated.
- 4.17** If a platform does not collect sufficient information and conduct appropriate due diligence on an underlying business or individual it is considering placing on its platform, this can lead to harm to investors.
- 4.18** On a Conduit or Pricing platform investors may be making decisions about which underlying asset to invest in based on incomplete and/or inaccurate information, if the platform does not have the systems and controls necessary to ensure that investors are given the right basic information about a borrower or company raising funds, or to check that this basic information is accurate.
- 4.19** In the Discretionary model (only observed in P2P) the platform will not be able to accurately assess and price risk if it has not collected the right information about the borrower. This makes it less likely that the platform can reliably deliver the target rate it has advertised to its investors (or to do so consistently over time).
- 4.20** For all types of platforms and business models, harm can arise if platforms do not take reasonable steps to counter the risk of the platform being used to further financial crime. Platforms' due diligence on fundraisers should assess whether they are legitimate. For example, obvious checks such as ensuring the company exists and that the founders are who they say they are should be carried out by all platforms as a minimum.
- 4.21** It is our view that it will be unlikely that a platform could argue that it has met its obligations under Principle 2¹⁴, Principle 6 (PRIN 2.1.1R)¹⁵ and the client's best interests

14 A firm must conduct its business with due skill, care and diligence

15 A firm must pay due regard to the interests of its customers and treat them fairly

rule (COBS 2.1.1R), if it has not undertaken enough due diligence to satisfy itself on the essential information on which any communication or promotion is based. Again, this applies to all platforms. In relation to statements about future commercial success, this should include at least a basic plausibility check. For example, if a borrower says it is going to build a block of flats within 6 months but it does not have the relevant construction permissions, it would seem reasonable for a platform to question the plausibility of the project.

- 4.22** We expect platforms to complete any necessary due diligence before they market investments to investors. In addition, the platform may become aware of new information that materially affects the borrower's credit risk after it has finalised its due diligence process, but before money has been irrevocably committed by investors. In this case and under the Principles of Businesses (PRIN), and the client's best interests rule (COBS 2.1.1R), we expect platforms to give investors the option not to proceed with the investment, as the conditions they based their investment decision on have changed. Platforms must respond appropriately to any information they receive and they should consider whether and how investors need to be updated and what this means for any secondary market that a platform might provide.
- 4.23** Some investors may also wish to undertake due diligence of their own before making an investment decision. The platform should ensure it provides enough information about the offer to allow investors to do this, and to make informed decisions. Where an investor is lending by way of business, it will be subject to a parallel obligation under CONC to assess the borrower's creditworthiness.
- 4.24** In light of the poor practices observed, the expectations created when a platform prices a loan or advertises a target rate, and the enhanced risk of harm if these expectations are not met, we are proposing explicit requirements for both Pricing and Discretionary platforms to assess credit risk in order to support what they market to investors. As the Pricing and Discretionary models are observed predominantly or solely in the P2P sector our rules are focused on P2P firms. We are also proposing rules to require P2P platforms to clearly describe their role to investors. See Chapter 5, paragraphs 5.5 to 5.22 and 5.65 to 5.73 respectively, which explain our specific proposal.
- 4.25** This is in addition to requirements on platforms to assess creditworthiness under our CONC rules, or to assess affordability under our MCOB proposals in Chapter 7.
- Insufficient ongoing disclosure**
- 4.26** Across all platforms, we have observed scenarios where something material about an underlying investment has changed, but that change has not been communicated to investors. For example, an investor may not be made aware that loans within their portfolio have defaulted. Lack of disclosure of such information appears more prevalent in platforms offering a discretionary secondary market facility, and for Discretionary platforms operating complex loan systems (both more prevalent in the P2P sector). We consider the lack of adequate ongoing disclosures can lead to harm, as investors who do not receive updated information may be prevented from understanding the risk they are or will be exposed to, or are prevented from making informed decisions about their investment.
- 4.27** To address this, we are proposing rules to require P2P platforms to provide ongoing disclosures to investors throughout the period of their investment. See Chapter 5, paragraphs 5.81 to 5.86 which explain our specific proposal.



Charging structures opaque and not related to costs

- 4.28** We have observed that some investors are not receiving the right information about the costs and charges associated with the service the platform is providing.
- 4.29** This is a particular concern in the P2P sector, where charging structures are often opaque. Clearly, it is appropriate for a platform to charge fees for the services it provides. It may be providing services to both the investor and the borrower, and charging may reflect this. However, fees charged need to be fair, transparent, and they should be separately and clearly disclosed to investors.
- 4.30** We have observed that platforms are paid for their services in a variety of ways. For example, some P2P platforms charge the borrower a fee for origination and ongoing servicing of loans. We also understand that some platforms may also receive ancillary fees, for example when a late payment is made on a loan.
- 4.31** In a number of cases, we have observed charging structures where P2P platforms take a variable differential between the money due to investors and the money paid by borrowers in interest (equivalent to net interest income). This structure, unless operated fairly and disclosed fully, can lead to harm to investors because fees cannot be understood.
- 4.32** In the context of a P2P loan, the investor is exposed to the underlying credit risk of the borrower, and has a direct relationship with them under a loan contract. This means that they bear the risk that the loan is not repaid; the platform is not usually exposed to this risk. Assuming the loan is priced fairly, where the interest a borrower is paying is higher (sometimes substantially) than the amount the investor is entitled to receive, with the platform receiving the difference, this is clearly in substance a charge to the investor and should be seen as such. In the absence of recognising such charges as costs to the investor, the investors are not being fairly remunerated for the real risk they are exposed to.
- 4.33** For example, we have seen cases where investors are receiving less than 3% return but are exposed to borrowers that are paying in the region of 30% interest. If the platform retains the difference, the platform is effectively charging a fee of around 27%, or alternatively, the borrower is being overcharged, or both. In this example, the underlying risk of the borrower is not being assessed properly, or the risk and reward structure being offered to investors is not balanced fairly, or both.
- 4.34** The way that fees are structured by the platform can also introduce additional conflicts of interest. For example, where P2P platforms retain the difference between the interest paid by borrowers and that paid to investors, there could be an incentive to facilitate increasingly risky loans at higher interest rates, to increase this marginal difference, and so the profit for the platform. If this happens investors are being exposed to greater risk without receiving greater reward. This risk is significantly compounded if investors do not know this, and cannot reasonably be expected to.
- 4.35** We already have rules governing disclosures on fees and charges; however, we propose to require platforms to explicitly set out the amounts deducted from interest paid by borrowers on P2P platforms. We also clarify that better and more comprehensive disclosure of other fees and charges is required by P2P platforms. See Chapter 5, paragraphs 5.79 to 5.83 which explain our specific proposal.

Inadequate risk management in P2P platforms to support advertised outcomes, fair valuations and fair pricing

Pricing at origination

- 4.36** In the P2P sector, we have seen a number of instances where it is not clear that the interest paid by the borrower is linked to the credit risk they pose, or that the return received by the investor reflects the investment risk they are prepared to take. It is not clear that basic disciplines around credit assessment and pricing that lenders in other sectors routinely apply are being applied by some P2P platforms. As a P2P platform facilitates the loan arrangements on behalf of an investor and does not lend from its own balance sheet, there is a greater risk of harm if this is not done properly as investors bear the credit risk directly.
- 4.37** At the centre of the P2P business model is a direct agreement between a borrower and an investor, at least one of whom must be a consumer. The investor bears the risk that the loan is not repaid. In a well-functioning market we would expect the investor to be rewarded fairly for taking this risk, so the information gathering stage before loans are placed on the platform for investors is crucial.
- 4.38** Where a platform has responsibility for pricing loans, it is our view that the platform should have a mechanism in place to ensure that the price it offers investors accurately reflects the credit risk of the borrower.
- 4.39** Setting the price can be done by setting the interest rate (for new loans) or by calculating the present value of the loan (both interest and the remaining principal) for existing loans being transferred to a different investor (for example, prefunded loans or loans transferred on the secondary market).
- 4.40** We consider it is important that P2P platforms which price loans (which P2P platforms do in nearly all cases) base the price on the risk posed by the borrower fairly and consistently. What a fair and appropriate price means will always involve a degree of judgement. However, price should be determined in good faith and based on a valuation appropriate to the types and risk profiles of the loans, and in line with market conditions. For example, what constitutes an appropriate valuation methodology, pricing and credit risk assessment for a loan to fund a property development will be very different to that for a loan to purchase a new car, because the investment risk profile of the loans is very different.
- 4.41** Many P2P platforms already conduct some credit risk analysis. However, we believe more detailed rules are necessary to ensure that platforms are explicitly required to have risk management frameworks that are, and remain, appropriate and effective to mitigate risks to investors. We expect platforms' risk management frameworks to differ depending on the type and complexity of the lending that they facilitate. See Chapter 5, paragraphs 5.5 to 5.14 which explain our specific proposal.

Ongoing valuations

- 4.42** We have observed a number of instances among P2P platforms where loans are being transferred to investors in a way that transfers value inappropriately. For example, transfers take place without taking into account the value of the loans at the point of transfer, or platforms have facilitated the transfer of pre-funded loans (arranged by either the platform itself or by a related company) without considering conflicts of interests. This risk can occur, for example, in a Discretionary platform when a platform automatically reassigns loans between investors.



- 4.43** When interest is set at the point of origination of a loan, it is important that that interest reflects the assessed credit risk. However, after this initial assessment it is possible that the risk profile of a borrower changes.
- 4.44** If a loan is moved in or out of an investor's portfolio, to ensure fairness, we think it is important that the valuation at which the transfer takes place is fair and appropriate of the value of the loan at that point in time. As with the setting of the interest rate, this will clearly require complex judgments, including about the expected future performance of loans. What information is needed to make such an assessment will vary depending on the underlying loan characteristics.
- 4.45** This is true whether the transfer is undertaken on a discretionary basis by the platform, or whether it is initiated by the investor but completed at a price set by the platform.
- 4.46** At the extreme, we have observed examples where loans that were already in default were added to an investor's portfolio without any consideration of what reduction in valuation would be required. Such practices lead to harm through investors not being adequately rewarded for the real risks they are taking or through exposure to inappropriate loans.
- 4.47** We are proposing additional rules to make more explicit what we expect in relation to ongoing valuations. See Chapter 5, paragraphs 5.15 to 5.22 which explain our specific proposal.

Achieving target rates

- 4.48** Where a Discretionary P2P platform advertises a target rate that it is trying to achieve within certain risk parameters, the P2P platform needs to understand not just individual loans, but also how the portfolio of loans that is allocated to an individual investor behaves as whole. Otherwise, it has no assurance that the advertised target rate of returns and risk parameters can be reasonably achieved for that investor. Investors will suffer harm if platforms cannot, within a reasonable degree of confidence, deliver in practice the returns advertised to investors when they made their initial decision to invest.
- 4.49** We think it unlikely that a platform could argue that it has appropriate systems and controls in place if it does not understand how the portfolio of loans behaves as a whole. As a result, we expect most platforms to already have measures in place along the lines discussed above. However, we are proposing additional rules to make this requirement more explicit. See Chapter 5, paragraphs 5.15 to 5.22 which explain our specific proposal.

P2P platform ceasing to operate would result in consumer losses

- 4.50** As part of our supervision and PIR work we have identified inadequacies with the comprehensiveness and effectiveness of some P2P platforms' wind-down arrangements should the platform fail. In other cases, it is unclear whether reasonable steps have been taken to put such arrangements in place, as required by existing rules.
- 4.51** The harm to the investor in the event of a P2P platform ceasing to provide management and administration services could be considerable if an effective run-off or transfer of business is not achieved. There is a risk that investors will not receive

some or all of the repayment of the loans they made through the platform, or that they will need to retrieve payments directly from borrowers themselves. As individual P2P agreements typically only represent small amounts of the total amount borrowed, it is unlikely to be economically viable for an investor to enforce their rights against a potentially very large number of individual borrowers. Conversely, where a single loan consists of multiple P2P agreements, the borrower might need to make repayments to multiple investors and needs the platform to facilitate this.

- 4.52** Our findings indicate that investors may not be aware of these potential outcomes before making their investment decision, which we think can be a potential cause of harm.
- 4.53** Under existing rules, a P2P platform is required to take reasonable steps to ensure that wind-down arrangements are in place to ensure that P2P agreements facilitated by it will continue to be managed and administered, in accordance with the contract terms, if at any time the platform ceases to carry on the activity of operating an electronic system in relation to lending.¹⁶
- 4.54** Our policy proposals, as explained in paragraphs 5.52 to 5.64 in Chapter 5, seek to clarify the existing requirements and provide further guidance on the issues and practical challenges that P2P platforms should consider when preparing wind-down arrangements for their businesses. We also propose new disclosure requirements to inform investors of the potential outcomes should the P2P platform cease to operate. Our proposals do not aim for a one-size-fits-all approach, or to ensure that investors never lose money, but they do seek to improve platforms plans and preparedness for their possible failure, to protect investors.
- Record keeping**
- 4.55** We have also observed that some P2P platforms might struggle to identify which loan and which payments relate to which investor at any given moment in time, in particular under a Discretionary business model where investors' portfolios change over time. This is despite article 36H of the Regulated Activities Order requiring a direct agreement between a borrower and an investor.
- 4.56** Under the current general record-keeping requirements all authorised firms are required to keep orderly records of their business, including all the services and transactions undertaken. This must be sufficient to enable us to monitor the firm's compliance with the regulatory system, and in particular to see that the firm has complied with all its client obligations.
- 4.57** It is important that a platform's internal systems and controls adequately reflect and support the complexity of its business model. In a complex model, to function well, the platform's record-keeping systems need to look similar to those of a UCITS operator, in which the granularity of information about individual holdings is immediately retrievable.

The investor is overexposed to an inherently risky asset class

- 4.58** However good the governance and controls that a platform has in place, the underlying investments and loans are generally high risk. When lending directly to individuals



or small businesses, or investing in early stage companies, there is a high risk that investors will lose some or all of their money.

- 4.59** In the P2P sector, we have observed a wide range of borrowers and types of loans, from companies raising funds for property development, to consumers borrowing to pay for consumables. In and of itself, this is not a problem. But we want to ensure that only consumers capable of understanding the risk and bearing the consequences take these investment risks.
- 4.60** In relation to investment-based crowdfunding platforms, marketing restrictions already apply.
- 4.61** The existing restriction for investment-based crowdfunding platforms (and similar investment activities) recognises the significant investment risks to investors when they invest in unlisted securities that are hard to value independently and cannot be sold easily (ie they are 'illiquid'). This restriction requires investment-based platforms that offer financial promotions directly to ensure that they offer these promotions to the following types of retail investors (in our Handbook 'retail clients') only:
- those who are certified or self-certify as sophisticated investors
 - those who are certified as high net worth investors
 - those who confirm before a promotion is made that, in relation to the investment promoted, they will receive regulated investment advice or investment management services from an authorised person, or
 - those who certify that they will not invest more than 10% of their net assets in readily realisable securities
- 4.62** Where no advice is given to retail clients, the platform must comply with the rules on appropriateness (COBS 10).
- 4.63** We believe many of the inherent risk characteristics of the investment-based crowdfunding market also exist in the P2P sector. Loans are unsecured and made to individuals and SMEs. The investors' ability to exit these agreements is not guaranteed, and the sector has not yet been through a full credit cycle. As a result of the PIR we have decided to consult on extending the marketing restriction that is already in place for investment-based platforms, to P2P platforms. See Chapter 5, paragraphs 5.43 to 5.51 which explain our specific proposal.
- Investors' interdependencies**
- 4.64** While investors make an individual investment, their ability to receive a return is linked to, and takes place in parallel with, other investors who have committed to the same investment on the same terms. This is true in both investment-based crowdfunding and P2P. For example, a borrower may secure a loan against an asset but no individual investor is likely to be able to enforce this (for small exposures it is unlikely that, for an individual investor, it will be economically viable to do so). Investors will naturally expect the platform to enforce the security on their behalf, but the platform may do this later than some investors would prefer. Investors can suffer harm if they do not understand these complexities, as they may make an incorrect assessment of the risks they are going to be exposed to if they invest.

- 4.65** It is essential that an investor understands how much their investment, or the security attaching to it, depends on the actions of others, including the platform if it directly (or through a related entity) acts on behalf of investors. Our proposed clarification that the role of the P2P platform needs to be clearly articulated to investors should mitigate potential harm in relation to this. We have focused our proposed rules on the P2P sector as we think the practical impact of the interdependencies may be less obvious to investors in loans, particularly where a single loan is made up of multiple investors. See Chapter 5, paragraphs 5.65 to 5.73 which explain our specific proposal.

Contingency funds operated by P2P platforms can provide a false sense of security

- 4.66** We have observed that some P2P platforms offer contingency funds (sometimes referred to as provision funds), designed to top up payments made to investors in the event of a borrower defaulting. Although we recognise these funds are intended to protect investors, we are concerned that they can obscure the underlying risk to investors. They can lead investors to believe that platforms provide a guaranteed rate of return on the loans they facilitate (similar to a fixed rate savings account). For example, we have seen risk warnings followed by statements that 'no investor has ever lost any money'. This statement, even if factually correct, could misleadingly imply that there have been no defaults or that an investment (capital or return) is unlikely to be impacted in the event of default.
- 4.67** We are concerned that the existence of a contingency fund could be used by a platform in lieu of calculating robustly whether the advertised return is achievable in practice, which then leads to unexpected losses.
- 4.68** In some cases, the implied and actual funding of the contingency fund also varies in an unacceptable way. For example, the size of the contingency fund communicated to investors may have been inflated by including future payments that have not yet been received.
- 4.69** Our proposals for a risk management framework, in Chapter 5, are designed to improve platforms' assessment of credit risk and price calculation. If a platform operates a contingency fund, it will need to factor the assertion it makes about its contingency fund into the things it has to consider as part of its risk management framework. This is because we do not consider it appropriate for a platform to rely on a contingency fund in place of good risk management.
- 4.70** Despite our concerns, we do not propose to prevent platforms from operating a contingency fund. Rather, we want to ensure they are run appropriately and that the operation and limitations are properly explained to potential investors. See Chapter 5, paragraphs 5.87 to 5.91 which explain our specific proposals.
- 4.71** We also highlight that, if a contingency fund is designed to provide lenders with an enforceable right to claim against it for losses arising on borrower default, then providing such a fund could amount to providing insurance. Before operating a contingency fund, a platform must satisfy itself that it would not be offering insurance. Where a platform claims that its contingency fund does not provide an enforceable right to claim for loss because the fund operates at the absolute discretion of the platform (including not paying anything at all), we would expect the platform to need



to show that the discretion has real content and is credible in the commercial context and is consistent with the Consumer Rights Act 2015 provisions on unfair contract terms. If a platform wants investors to have the benefit of an enforceable right to claim for losses where a borrower defaults, or a 'guarantee', to investors, it could consider arrangements where an authorised insurer offers cover.

False perceptions about liquidity and investor's ability to exit

- 4.72** Some platforms operate a secondary market to create liquidity for their investors.
- 4.73** In the P2P sector, this is done by allowing investors to exit an arrangement with a borrower by selling their loan part to another investor. Such services can encourage investors to think that their investment is liquid, much like a deposit account. This can lead to two main risks of harm. Firstly, platforms cannot guarantee that there will be investors wanting to buy out loans at all times. This can force investors to hold their loans to maturity, when they were planning to exit earlier than that based on an assumption that there will always be liquidity. Secondly it can mean that investors may not understand that they may lose money by exiting the original arrangement, or that they may receive less than if they had held the loan until maturity. This 'opportunity cost' is not in itself a source of harm to the investor, if the price they receive is understood and reflects the fair value of the loan at that time.
- 4.74** We have also seen examples that the valuation of loans by platforms on secondary markets is not always transparent or consistent with efficient markets. This creates the potential for harm as investors may not understand how the value of the transferred loan has been calculated and whether it is 'fair'. This risk is enhanced in the context of P2P platforms that advertise a target exit date for the investor, but allocate contracts with a longer maturity date to them. This maturity mismatch (the actual loans are of a different length than the advertised exit date) relies on new investors taking on agreements, or loans being repaid early, to achieve the target date advertised to the investor.
- 4.75** We are proposing additional disclosure requirements and measures for credit assessment and fair valuation, which apply to secondary market transactions as well as at loan origination. See Chapter 5, paragraphs 5.8 to 5.22 which explain our specific proposal.
- 4.76** In investment based crowdfunding, secondary markets are typically bulletin boards. It is still important that investors understand there may be limited liquidity, but we have not perceived the same risk of mismatched expectations as we have in the P2P sector.

Q3: Do you have any comments on the analysis of harm in this section?

5 Proposed changes for P2P platforms

- 5.1** In this chapter, we describe the rules and guidance we propose to make for the P2P sector in more detail. In developing our proposals we want to prevent possible harm to investors, and to do so in a proportionate and flexible manner, given the diverse and complex business models operating within the sector.
- 5.2** We recently published Policy Statement 18/14 in relation to the Senior Managers and Certification Regime (SM&CR), which will apply to crowdfunding platforms regardless of whether they are investment-based or P2P platforms, from 9 December 2019. The aim of the SM&CR is to reduce harm to consumers and strengthen market integrity by creating a system that enables firms and regulators to hold people to account. As part of this, the SM&CR aims to encourage staff to take personal responsibility for their actions, improve conduct at all levels, and make sure firms and staff clearly understand and can demonstrate who does what.
- 5.3** In addition to the changes explained in PS18/14, for the P2P sector we are proposing to strengthen and clarify the existing P2P requirements and standards, to improve investor protection and provide greater certainty on what we expect from P2P platforms. There will not always be a one-size-fits-all approach to compliance with our proposals. As such, there are some areas where platforms will have varying implementation options. These include, for example, simplifying elements of their business model, or amending their processes and systems to comply with the more detailed rules.
- 5.4** Some platforms operate as an appointed representative. While the proposed rules in this chapter would apply to the activities of the principal authorised platform, the principal firm is responsible for ensuring compliance with our rules by all of their appointed representatives.

Risk management framework

- 5.5** PRIN 2.1.1R already requires platforms to conduct business with due skill, care and diligence and take reasonable care to organise and control their affairs responsibly and effectively, with adequate risk management systems. Furthermore, SYSC 4.1.1R requires platforms to have robust governance arrangements. This includes having effective processes to identify, manage, monitor and report on the risks the platform is or might be exposed to.
- 5.6** We have described in previous chapters that platforms need to be able to meet the expectations they create in respect of their offering to investors. To be able to do this, P2P platforms need to understand and be able to price the credit risk of the loans they facilitate, at origination and over time. To do this they need to have an appropriate risk management system in place.
- 5.7** We are thus proposing to add more detailed requirements to address the specific nature of some services offered by P2P platforms.



Risk management in relation to the basic pricing of a loan

- 5.8** For those platforms that set the price of the agreement, we propose prescriptive rules for a risk management framework, to require that, as a minimum, a platform:
- a.** gathers sufficient information about the borrower to be able to competently assess the borrower's credit risk
 - b.** categorises borrowers by their credit risk in a systematic and structured way (taking into account the probability of default and the loss given default)
 - c.** sets the price of the agreement so it is fair and appropriate, and reflects the risk profile of the borrower
- 5.9** The prices set should consider as a minimum the time value of money and the credit spread for the specific loan.
- 5.10** These requirements describe the basic controls that any other lender should have in place to assess whether or not to lend to someone, and on what terms. We believe such controls are as important in the context of P2P platforms as they are in the context of lenders who commit their own capital. This is because investors rely on the platforms to price agreements fairly and appropriately.
- 5.11** The information-gathering stage exists to ensure that a platform knows enough about an underlying borrower to set a fair and appropriate price. If a platform is required to do a creditworthiness assessment under our Consumer Credit sourcebook (CONC) rules, or our proposed affordability assessment under the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB) rules (see Chapter 7), it already needs to gather sufficient information to consider affordability for the borrower. To reflect this, our proposed information gathering rules can be met by complying with these existing requirements, however, the platform will need to use that information as part of its risk management framework.
- 5.12** The risk management framework should be appropriate for the complexity of the platform's business model and the type of lending facilitated. Platforms with a large number of homogeneous loans might seek to use a statistical model with external and internal data, while for platforms with fewer and/or more heterogeneous loans it may be more appropriate to use a simpler ranking procedure. Similarly, consumer lending models may differ from those facilitating business lending.
- 5.13** The risk management framework needs to be appropriately tested, including considering how predicted outcomes compare to actual outcomes over time, with the results used to enhance and improve the model as necessary.
- 5.14** We have intentionally not attempted to prescribe what valuation models or methodologies a platform may use. Due to the diversity of business models and asset classes in the sector, different methodologies will be appropriate for different firms' loan books. There are however, generally accepted standards and practices relevant to assessing and managing credit risk that platforms can refer to in designing their own systems.¹⁷

¹⁷ For example, Basel's credit risk framework or The Joint Forum report on developments in credit risk management across sectors.

Q4: 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 structured way, and**
- c) price the loan so it adequately and fairly reflects the credit risk determined in a)? If not, please explain why.**

Q5: 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?

Additional risk management for more complex models

- 5.15** If a platform is offering investors a target rate of return for a P2P portfolio which it assembles or manages, it is acting as a decision maker, exercising discretion on behalf of investors. Our proposals make clear that the platform should have a reasonable basis to conclude that the return it is advertising to investors can reasonably be achieved within the risk parameters originally advertised.
- 5.16** In addition, our proposals also make clear that where the platform chooses which loans to facilitate for an investor the platform should ensure that investors are only exposed to loans that, at the point they are allocated to an investor, meet the risk parameters advertised at the time of investment. The platform must have and use a risk management framework that is designed to achieve this.
- 5.17** In models where the platform facilitates an exit for a lender before the original maturity date of the loan, it must ensure that this is done at a fair and appropriate price.
- 5.18** As an example, a platform might categorise loans as A, B, C or D depending on the risk, and advertise a target rate of return of 3% composed of loans A, B and C. If it did so, the platform will not be able to expose investors that have invested under these conditions to loans categorised as D at the point it is allocated to the investor, or at any re-balancing of the portfolio. It is, of course, possible that the credit quality of the original loans may deteriorate over time, but when loans are added to a consumer's portfolio they should not be outside the criteria advertised to the client when they committed to invest. For example, loans that started off as risk rated A, B or C may degrade to D over time, and this is acceptable (however our proposals in relation to ongoing disclosure in paragraphs 5.81 to 5.83 explain how we think investors should be provided with fair updated information regarding their investment where appropriate). However, what is not acceptable is to allocate new or existing loans to the investor's portfolio that at the time they are added are rated D, as this is outside the risk criteria the investor signed up to.
- 5.19** Platforms must ensure that their risk management framework is adequate at all times. In practice, this means that the expected target rate of return predicted by the framework should match the expected outcome, within a reasonable degree of confidence. To ensure that the risk management framework is sound, we propose that



platforms should keep it under review by assessing outcomes against expectations, modifying it if necessary. In other words, expected and actual returns should not diverge considerably.

5.20 As part of this, we expect that platforms should only expose investors to services which they can adequately control and manage. Providing a product that offers a target rate of return amounts in our view to the provision of a complex financial service, and so it requires controls commensurate with this. Depending on the type of lending they facilitate, some platforms may find it more appropriate to simplify their business model, rather than investing in upgrades to their control environment.

5.21 Any system also has to be adequate to assess price and value over time. This is particularly relevant when a platform exposes investors not just to newly originated loans (for which the interest is being set at that point), but to existing loans (for which an interest rate is already set contractually). This could happen for a variety of reasons. Some platforms pre-fund loans, others reallocate loans to different investors over time. At the point an investor enters into, or exits, a loan, such a transaction needs to take place at a fair valuation. If fair value is not reflected, value is inappropriately transferred from one investor to another or from investors to platforms. As the interest rate will already be contractually set for loans that exist, the only adjustment that can be made is to the amount at which the loan is transferred compared to outstanding payment (ie any discount to its face value).

5.22 As a minimum, platforms must re-value loans that have defaulted. However, platforms may need to consider valuations more frequently depending on their business model.

Q6: **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?**

Q7: **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.**

Q8: **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.**

Q9: **Do you agree that a P2P platform's risk management framework must be adequate to assess price and value over time, ie for newly originated and, for example, for loans that have defaulted? If you do not agree, please explain why.**

Q10: 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 agreements on behalf of investors?

Conduit platforms

5.23 As set out in Table 1, Chapter 3, Conduit platforms do not set the price of a loan – it is set through negotiation between the investor and the business or individual borrowing. For such platforms, the requirements in this section may not be mandatory, but it would be good practice to consider whether, depending on their business model, they need to apply those same principles to ensure that investors have access to adequate information.

Governance

5.24 This section considers governance within P2P platforms on two levels:

- a.** the general governance of the platform and the controls in place to monitor risks and regulatory compliance
- b.** development and oversight of the risk management framework

General governance of the platform

5.25 To make risk management effective, we believe it needs to be underpinned by the right governance structures.

5.26 We have looked at the characteristics of P2P platforms and compared these to the regulatory standards that apply to firms in different sectors carrying out similar activities. We think that the standard that platforms should be held to should be comparable to the standards applicable to firms conducting certain types of investment business (for example, arranging deals in investments or dealing as agent) and with investment managers. We propose to bring P2P platforms more into line with the systems and controls requirements that apply to these types of firms.

Risk management function

5.27 We propose to build on the existing high level requirement that platforms must have robust governance arrangements.¹⁸ This already requires platforms to have effective processes to identify, manage, monitor and report on the risks they are or might be exposed to.¹⁹ We are proposing to additionally require a P2P platform to, in particular:

- establish, implement and maintain adequate risk management policies and procedures, including effective procedures for risk assessment, which identify, manage and monitor risks relating to their activities, processes and systems; and
- have an independent risk management function, depending on the nature, scale and complexity of its business and the nature and range of the services undertaken

¹⁸ SYSC 4.1.1R

¹⁹ CP17/27 proposes additional requirements in relation to policies and procedures for assessment of creditworthiness in consumer credit, including by P2P platforms, which similarly build on existing SYSC requirements.



in the course of that business. This function should implement, and monitor the adequacy and effectiveness of, the platform's risk management policies and procedures, and

- report to and advise the platform's senior management on matters of risk

Compliance function

5.28 We propose a similar approach for a P2P platform's compliance function. Platforms are already required to establish, implement and maintain adequate policies and procedures sufficient to ensure compliance with their regulatory obligations.²⁰

5.29 In addition to this, we propose that P2P platforms must maintain a permanent and effective compliance function which operates independently and which:

- monitors the adequacy and effectiveness of its policies and procedures designed to detect compliance failings, and the actions taken to address deficiencies
- advises and assists the relevant people within the platform on compliance matters

5.30 For a compliance function to discharge its responsibilities properly and independently, we propose to require P2P platforms ensure that, in particular:

- the people involved in the compliance function are not also involved in the services or activities they monitor, where this is proportionate
- there is a method of determining that people involved in the compliance function are remunerated in such a way as to not compromise their objectivity, where this is proportionate

Internal audit function

5.31 Once again, we propose a similar approach for a P2P platform's internal audit functions. We propose that, where appropriate and proportionate in view of the nature, scale and complexity of the platform's business, a P2P platform must establish and maintain an internal audit function which is separate and independent from the other functions and activities of the platform and which is responsible for:

- establishing, implementing and maintaining an audit plan to examine and evaluate the adequacy and effectiveness of the platform's systems, internal control mechanisms and arrangements
- issuing recommendations and verify compliance with those recommendations
- reporting to the platform's senior personnel on internal audit matters

When does the requirement for independent risk and internal audit functions become applicable?

5.32 Given the diversity within the sector we are not setting a fixed threshold as to when these additional requirements become applicable, as this will be a matter of judgement on a case-by-case basis. However, we think that larger platforms operating a business model that sets the price and chooses the investor's portfolio to generate a target rate

20 SYSC 6.1.1R – CP17/27 also proposes enhancements in this area.

(the Pricing platform and the Discretionary platform, as described in Table 1), are likely to be complex enough to require independent risk and internal audit functions.

- 5.33** Platforms that do not have independent functions should be able to demonstrate why it is not proportionate to have these, and must also be able to demonstrate that they nonetheless have effective compliance and risk management policies and procedures in place. We explain the interaction between these proposals and the Approved Persons Regime and the SM&CR in the following paragraphs.

Approved persons

- 5.34** Where independent risk management and independent internal audit functions are appropriate, responsibility for each must be clearly allocated at a senior level. Under our proposals, those responsible would require approval under the Approved Persons Regime (under Controlled Function 28: Systems and Controls²¹) if they are not already approved to perform a governing function. This is to ensure they are subject to The Fit and Proper test for Approved Persons²² and the Statement of Principles and Code of Practice for Approved Persons.²³ Compliance officers are already required to be approved²⁴ (under Controlled Function 10: Compliance Oversight²⁵) under our Approved Persons Regime.
- 5.35** Platforms should note that we intend to replace the Approved Persons Regime with the Senior Managers & Certification Regime (SM&CR). HM Treasury has confirmed that the SM&CR will apply to solo-regulated firms from 9 December 2019. In relation to a person performing Controlled Function 28, the Certification Regime may, and the Conduct Rules will, apply to these individuals from that date – for example, as a Material Risk Taker or the Significant Management Function. In relation to a person performing Controlled Function 10, the Senior Managers Regime will apply from that date. For more details please refer to Policy Statement 18/14.²⁶
- 5.36** The governance proposals in this section, and associated provisions, currently apply to P2P platforms as guidance. We, therefore, propose to make these provisions into rules so that platforms are clear about our expectations.

Q11: 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?

Conflicts of interests

- 5.37** We are not proposing new rules to manage conflicts of interest because our existing rules are clear and they should already be integrated into overall systems and controls, and governance processes. However, we wish to highlight the importance of these rules given the findings of our PIR.

21 SUP 10A.8.1R

22 www.handbook.fca.org.uk/handbook/FIT/1/?view=chapter

23 www.handbook.fca.org.uk/handbook/APER/1/?view=chapter

24 SYSC 3.2.8R

25 SUP 10A.7.8R

26 www.fca.org.uk/publication/policy/ps18-14.pdf



5.38 Under current rules²⁷ a P2P platform must take all appropriate steps to identify and to prevent or manage:

- a. conflicts of interest between itself (or any person directly or indirectly linked to it by control) and a client of the platform
- b. conflicts of interest between one client of the platform and another client

5.39 These steps should recognise that, in reality, most platforms do more than simply facilitate loans. In particular, platforms should not engage in practices that create a financial incentive for them to facilitate loans in a way that favours the platform or a certain cohort of investors/borrowers and is not transparent to all investors. Such incentives can arise where there are:

- opaque fee arrangements between borrowers and the platform
- group structures that generate additional and invisible layers of earnings for the platform itself. For example, a company within the same group as a platform prefunds loans and sells them to the platform via novation, but the group company retains a stake in each loan and the price of the loan is set at a higher rate of interest than that received by retail investors

5.40 Some other examples of conflicts of interest that we have seen are:

- platforms that allow staff or family members to transact on the secondary market, creating a risk that they have access to information that is not available to all investors which may benefit them
- platforms (sometimes through parent companies) that hold 'skin in the game' (ie they buy a part of the loans they help originate). Even though this can lead to a better standard of due diligence, it can also lead to conflicts of interest if they are able to use the secondary market to sell out early (possibly based on greater access to information), rather than holding to maturity
- platforms whose directors have presented loans for connected businesses but have not declared these connections to investors
- the transfer of loans from one client to another at an inappropriate price

5.41 Through our supervision work we will look for visible improvements to platforms' systems and controls to manage any conflicts of interest

Development and oversight of the risk management framework

5.42 In addition to our risk management framework proposals, we propose that the person(s) with overall responsibility within the platform for the establishment and maintenance of a platform's risk management framework must be a person approved for a significant influence controlled function (and under the SM&CR, a person approved for a senior manager function), such as a director. They must be suitably qualified and competent to have this responsibility. As with all approved persons, the Fit and Proper test and the Statement of Principles and Code of Practice for approved persons would apply.

27 SYSC 10.1.3R

Q12: 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?

Marketing restrictions

- 5.43** As set out in previous chapters, many of the types of loans facilitated by P2P platforms are inherently risky. High risk of loss is not of itself a source of harm to investors, if investors knowingly choose to invest in a product where they are exposed to that level of risk. In a well-functioning market, for those prepared to accept higher levels of credit risk, these loans should provide opportunity to gain higher returns in an environment where many investors are searching for yield. However, as discussed, we are not comfortable that risk and reward are always balanced appropriately on all P2P platforms, and we are concerned that investors cannot assess their risk exposure due to the ways platforms operate.
- 5.44** The role of platforms in administering, servicing and, in some cases, managing loans is complex. This makes it difficult for investors to assess investment risk properly. There are additional risks if platforms become insolvent, with investors likely to lose some or all of their money, without the backstop of the FSCS.
- 5.45** While the types of loans facilitated by platforms vary, data indicate that some underlying loans are made to borrowers that do not find it easy to meet interest payments on their loans.²⁸ This has not necessarily resulted in higher defaults as yet, but the sector is relatively new and has not been through a full economic cycle. For example, interest rates have been historically low since before 2014. While there are a relatively large number of active platforms, most of these are still in growth mode, seeking to facilitate more loans and reach the point where economies of scale will allow them to generate and sustain profits. In our view, this means that platforms might diversify into riskier markets or products, or a platform might have limited previous experience to assess risks adequately. Also, a number of platforms have told us that their growth is constrained by the lack of demand from borrowers, rather than any shortage of willing investors.
- 5.46** In our view, these characteristics need to be seen in the context of the current interest rate environment and broader economic context. Typically, when such markets move through a full economic cycle we would expect to see defaults of loans begin to increase.
- 5.47** The industry is also still maturing, and a number of platforms may exit the market and we might expect to see some consolidation. This is an important part of any sector reaching maturity and this is likely to be the same for the P2P sector. However, as part of managing this change we want to ensure that investors are appropriately protected and only exposed to the risk of loss that they reasonably understand they are exposed to and can bear.



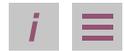
- 5.48** To ensure investors do not overexpose themselves to an asset class in which they may incur notable losses, without understanding that this may happen, we propose to limit P2P platforms' ability to market to certain investors. It has not been possible to quantify the exact number of investors currently at risk of over exposure. However, from a survey of 4,500 P2P²⁹ investors, 40% said they had invested more than their total annual income and, of those, half had invested more than double their annual income. The proposals should make investors less likely to be overexposed to such assets and limit their potential losses. The proposal will not trigger divestment for any existing investors as the requirements will not apply retrospectively.
- 5.49** In particular, we propose to require P2P platforms that communicate direct offer financial promotions for P2P agreements to only communicate these promotions to the following types of investors (in our Handbook 'retail clients'):
- those who are certified or self-certify as sophisticated investors
 - those who are certified as high net worth investors
 - those who confirm before a promotion is made that, in relation to the investment promoted, they will receive regulated investment advice or investment management services from an authorised person, or
 - those who certify that they will not invest more than 10% of their net investible portfolio in P2P agreements
- 5.50** Where no advice is to be given to retail clients, we also propose that platforms that communicate direct offer financial promotions for P2P agreements should comply with the rules on appropriateness (COBS 10). This should ensure that investors are assessed as having the knowledge or experience to understand the risks involved before they can invest.
- 5.51** These proposed rules aim to ensure that investors continue to have a wide range of investment opportunities and that P2P platforms continue to provide an alternative source of finance for borrowers. However, in achieving these two outcomes it is important that investors are not exposed to undue levels of harm.

Q13: Do you agree with our proposals to apply marketing restrictions to P2P platforms? If not, please explain why.

Wind-down arrangements

- 5.52** P2P lending is underpinned by direct contracts between investors and borrowers. While the returns of the platform are, of course, affected by the payment profile of the underlying borrowers, the platform itself is not generally exposed directly to the underlying loans themselves. In line with this, platforms currently have relatively low capital requirements compared with other types of investment providers.

- 5.53** However, as we have explained in previous chapters, the systems operated by platforms are extremely complex and there is a risk that they could not be easily administered by a third party.
- 5.54** If a loan portfolio cannot be administered successfully because a platform has ceased to operate, investors are in practice exposed to the credit risk of the platform as much as they are to the underlying loans. As such it is essential that platforms have in place comprehensive and effective wind-down arrangements to give the greatest possible chance that loans will continue to be managed and administered should the platform cease to do this.
- 5.55** Under existing rules a P2P platform is required to take reasonable steps to ensure that arrangements are in place to ensure that P2P agreements facilitated by it will continue to be managed and administered in accordance with the contract terms if at any time it ceases to carry on the activity of operating an electronic system in relation to lending.
- 5.56** In practice, we have observed at times that platform arrangements are inadequate (as described in Chapter 4). We therefore propose to strengthen and clarify this existing rule to make clear that platforms must have arrangements in place to ensure that the P2P agreements they facilitate will have a reasonable likelihood of being managed and administered, in accordance with the contract terms, if the platform ceases to carry out those functions itself. This applies regardless of the type of business model operated by a platform. For example, a Conduit platform will need arrangements to ensure loans continue to be administered, but a Discretionary platform will need arrangements to ensure a portfolio of loans continues to be administered and managed.
- 5.57** We also propose further guidance explaining what platforms' arrangements might include in practice and what they may need to consider to ensure their arrangements address the real challenges faced by a platform which may no longer be a going concern. For example, as part of its planning a platform may consider obtaining prior and informed consent from:
- investors to fund the continued cost of management and administration of their respective loans through, for example, increased commissions, and/or
 - investors and borrowers for the transfer of the service of managing and administration of P2P agreements from the platform to another firm
- 5.58** When assessing the adequacy of its wind-down arrangements, a platform should consider the need to obtain professional advice on the likelihood of its arrangements securing the outcome for continuity of management and administration of P2P agreements.
- 5.59** A platform should also consider, among other things, the extent to which any practical obstacles could foreseeably prevent the wind-down arrangements. For example, in assessing the adequacy of its arrangements a platform should consider whether the terms included in relevant contracts are enforceable, for example terms in customer, service and supplier contracts.
- 5.60** Platforms that are contemplating ceasing to manage and administer P2P loan agreements facilitated by them, or contemplating implementing their wind-down arrangements, should notify the FCA in writing of this in line with existing notification



requirements in Principle 11 and SUP 15.3.8G. We propose to add guidance to make this clear.

Q14: Do you agree with the proposed modification to the systems and controls rules regarding wind-down arrangements? If not, please explain why.

- 5.61** For platforms to have arrangements that are likely to be effective, we propose to require platforms to produce and keep up-to-date a manual containing information about their operations that would assist in resolving the platform in the event of its insolvency. We have called this a 'P2P resolution manual' in our proposed rules.
- 5.62** A platform's P2P resolution manual must include, as a minimum, a written explanation of how the platform conducts the business of management and administration of P2P agreements that it has facilitated, what the day-to-day operations of that business entails, and what resources would be needed to continue that business if the platform ceased to carry it on, including a specification of:
- critical staff and their respective roles
 - critical premises
 - IT systems
 - record keeping systems, including how records are organised
 - all relevant bank accounts and payment facilities
 - all relevant persons outside the platform and their respective roles, including any outsourced service providers and
 - all relevant legal documentation, including customer, service and supplier contracts
 - a group structure chart
 - the steps that would need to be implemented under the wind-down arrangements
 - any terms in contracts that may need to be relied upon and
 - how the platform's systems can produce the detail specified in respect of ongoing disclosures (our proposals for ongoing disclosures are explained from paragraphs 5.80 to 5.91 below)
- 5.63** This is particularly relevant as each platform is likely to have arrangements, IT systems, and possibly proprietary software, specific to their business model. We also propose that platforms must put in place arrangements to ensure that their P2P resolution manuals would be immediately available to an appointed administrator, receiver, trustee, liquidator or similar officer, or the FCA, on request, and must store its P2P resolution manual in the same place as its CASS resolution pack, if applicable.

- Q15: 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?**
- Q16: Have we correctly identified the information that should be included in the P2P resolution manual? If not, what other information should be included?**

5.64 A possible addition to the proposals in this section is to mandate additional prudential requirements for P2P platforms. Holding additional capital in a ring-fenced structure, to be used solely for the purpose of winding down a platform's business in the event of insolvency could help to achieve the desired outcome of continued management and administration of loans in accordance with original contract terms. However, it would create an additional prudential burden on platforms, which may be difficult to calibrate and implement in practice. Therefore, we are not proposing such an approach in this CP, but welcome views on this and whether it is something that we should consider in future, to protect investors in the event of platform failure.

- Q17: 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?**

Disclosure requirements

- 5.65** The investment opportunities offered by different P2P platforms vary enormously, and investors need a clear understanding of what they are exposed to, what risks and opportunities the investment involves, and what the platform's role is. Communications with investors already have to meet the general test of fair, clear and not misleading³⁰ and platforms are already required to provide investors with information about the nature and risks of the investment³¹, but to ensure that our expectations of the minimum information investors need are clear, we propose adding a number of detailed requirements on the disclosures provided to investors.
- 5.66** As explained in previous chapters, we have seen numerous examples of poor disclosures. We propose more granular disclosure requirements to reduce the risk of poor disclosures being provided to investors.
- Information about the role of the platform**
- 5.67** Given the diversity of platforms operating in the P2P sector, it is important relevant information is made available to investors. It should be easy to understand and make comparing the investment opportunities across platforms as easy as possible.
- 5.68** The investor must be able to understand not only the nature of the investment and the risks involved, but also the service that is being provided by the platform.

30 www.handbook.fca.org.uk/handbook/COBS/4/2.html

31 www.handbook.fca.org.uk/handbook/COBS/14/3.html



- 5.69** In particular, we propose that P2P platforms must provide a description of their role, including:
- the nature and extent of the due diligence it undertakes in respect of borrowers
 - a description of how loan risk is assessed, including a description of the criteria that must be met by the borrower before the platform considers the borrower eligible for a P2P agreement
 - whether and what role the platform will play in determining the price of a P2P agreement
 - where investors do not have the choice to enter into specific P2P agreements, what role the platform will play in choosing P2P agreements for an investor
 - where a platform offers a portfolio of loans to investors, what role it will play in composing that portfolio
 - an explanation of how any tax liability for lenders arising from investment in P2P agreements would be calculated
 - an explanation of the procedure for dealing with a loan in late payment or default
 - a clear statement that that there is no recourse to the FSCS
 - if a platform offers a secondary market facility and, if so, the procedure for a lender to access their money before the term of the P2P agreement has expired and the risk to their investment of doing so
 - whether the firm displays P2P agreements that lenders wish to exit and that other investors may choose to enter into
 - whether the firm decides if the P2P agreement should be transferred to another investor without involving either investor in that decision
- 5.70** In addition, it is important that potential investors understand the practical impact of providing a direct loan(s) to a borrower(s) under a P2P agreement. Building on existing guidance that a P2P platform should explain what happens if the platform fails, we propose requiring that investors be notified about a platform's wind-down arrangements in good time, before the platform carries out the relevant business for the investor. Where a platform's arrangements include particular terms in contracts with investors, or require obtaining particular prior consents from them, we propose that the platform must clearly identify these and explain how they operate. We also propose that a platform notify investors of the name of any third party with whom arrangements have been made to take over the management and administration of P2P agreements if the platform ceases to operate, and how they will hold investors' money, whether that person is authorised by the FCA and, if it is, what permission they hold.
- 5.71** Further, we propose that platforms must explain the risks of the possibility that, in the event of the platform's failure:
- P2P agreements may cease to be managed and administered (essentially leaving investors to recover repayments directly from borrower(s))

- because of the specific provisions in 36H, any third party involved in the continued management and administration of the P2P agreements after the platform fails may not be subject to the same regulatory regime and requirements as the platform, and the resulting possibility that regulatory protections may be reduced or no longer available
- the likelihood is that the majority of balances due to the investor are repayments yet to be made by borrowers. Such future payments do not fall under the definition of client money. So if the platform fails a lender's entitlement to any client money held by the platform would not include repayments that the platform has not yet received from borrowers

5.72 In relation to the second bullet point above, a practical example of where regulatory protections might change is if the loan management service were to transfer to a firm that is not authorised as a P2P platform operator, but is authorised to carry on debt administration and debt collection. In this scenario, the client money rules would not apply and the conduct of business requirements would be different.

5.73 If a platform's wind-down arrangements change for any reason, we also propose that the platform must provide updated information to their investors.

Q18: **Do you agree with our proposals to clarify the information that a P2P platform should provide regarding its role?**

Q19: **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?**

Investment information

5.74 Our conduct of business rules require all platforms to provide a description of the risks that the investor will be exposed to.³²

5.75 In relation to investment risk, there is existing guidance which explains what a P2P platform should include in its disclosures.³³ In this section we propose to make the existing guidance into mandatory requirements in rules, and make amendments to it, to be clearer about our expectations.

5.76 We also include proposals to make more specific disclosure requirements to ensure that investors are provided with relevant information about an investment, to improve transparency of the fees and platform charges for the services provided, and to help prospective investors compare investment opportunities across different platforms. Our proposals aim to ensure investors have a clear understanding of whether the platform achieves what it has advertised.

5.77 Our proposals recognise that different platform models require different investment information. For example, where the platform determines the price of P2P agreements, we think investors should be able to consider the level of risk before their money is invested, and they should be informed of any changes to the risk categorisation after investing (by risk category we mean the risk categories set out

32 COBS 2.2.1R

33 COBS 14.3.7AG(1)-(10)



in the risk management framework, as described at paragraph 5.5 onwards). These changes should only arise from changes in the profile of loans throughout their life and never from the platform exposing investors to loans that do not meet the advertised criteria at the time they entered into the arrangement.

5.78 We are also proposing that disclosures should be made to a lender in a durable³⁴ form or made available on a website in good time before the platform carries on any business for that lender. Material revisions to the information should also be disclosed in durable form or made available on a website, and in good time.

Information to be disclosed where the investor chooses individual P2P agreements

5.79 In particular, we propose the following information be disclosed to investors, in good time before they invest, where the investor selects individual P2P agreements (ie the Conduit or Pricing platform models):

- where the platform determines the price of the agreement, details of the price including the annual percentage rate to be paid by the borrower
- when the P2P agreement is due to mature
- the frequency of and amounts of the repayments to be made by the borrower
- the total amount to be paid by the borrower
- a fair description of the likely actual return, taking into account fees, default rates and taxation
- where the firm determines the price of P2P agreements, details of the credit risk assessment, creditworthiness assessment or assessment of affordability under MCOB carried out
- whether the P2P agreement is backed by an asset (for example, secured against property developments) and if so, what
- fees to be paid by the borrower or the investor, including any deduction from the interest to be paid by the borrower and
- where the firm determines the price of P2P agreements, the risk categorisation of the P2P agreement, and an explanation of it, by reference to the risk categories set out in the risk management framework

Information to be disclosed where the platform allocates P2P agreements to investors

5.80 For Discretionary platforms (where the platform selects the P2P agreements on behalf of the investor or manages a portfolio of loans to achieve a target rate), we propose the following be disclosed in good time to investors before they investment:

- the minimum and maximum interest rate that will be payable
- the minimum and maximum maturity date of any P2P agreement that may be facilitated for the investor

34 www.handbook.fca.org.uk/handbook/glossary/G1286.html?starts-with=D

- a fair description of the likely actual return, taking into account fees, default rates and taxation
- fees to be paid by the borrower or the investor, including any deduction from the interest to be paid by the borrower and
- the range and distribution of risk categories that the P2P agreements may fall into, and an explanation of those, by reference to the risk categories set out in the risk management framework

Ongoing disclosures

5.81 We propose that a P2P platform must ensure that, at any point in time, its customers are able to access details of each P2P agreement they have entered into, including:

- the price of the P2P agreement
- the annual percentage rate that will be paid by the borrower in respect of that P2P agreement
- the outstanding capital and interest payments in respect of that P2P agreement
- when the P2P agreement is due to mature
- any fees paid in respect of that P2P agreement by the investor or the borrower
- if the platform has carried out a valuation of the P2P agreement, details of that valuation and an explanation of why the platform conducted the valuation
- a fair description of the likely actual return, taking into account fees, default rates and taxation
- where the platform determined the price, details of the credit risk assessment, creditworthiness assessment or assessment of affordability under MCOB carried out
- whether the P2P agreement is backed by an asset (for example, secured against property developments) and if so, what
- the risk categorisation of each P2P agreement and an explanation of that risk categorisation, by reference to the risk categories set out in the risk management framework and
- whether there has been a default by the borrower

5.82 We propose that a P2P platform must, at least, carry out a valuation of a P2P agreement following a default.

5.83 One of the consequences of the ongoing disclosures is that, if a platform offers investors secondary market facilities, investors should have up-to-date information before selling or buying a loan and this information should be reflected in the price.



Outcomes statement

5.84 Investors should also have a clear understanding of whether the platform achieves what it advertises.

5.85 Where a platform sets the price (Pricing platforms and Discretionary platforms), we propose that it must publish an 'outcomes statement', within 4 months of the end of each financial year, which includes:

- the expected and actual default rate of all P2P agreements the platform has facilitated by risk category, by reference to the risk categories set out in the risk management framework
- a summary of the assumptions used in determining expected future default rates and
- where the platform offered a target rate, the actual return achieved

Q20: 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 explain why.

Q21: 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?

5.86 We are also proposing to define what constitutes default for the purposes of producing the outcomes statement using the definition in the Capital Requirements Regulation³⁵ to ensure consistency across platforms. Under this definition, a loan would have defaulted when the borrower is past the contractual payment due date by more than 90 days, or 180 days for property loans.

Q22: Do you agree with standardising the definition of default? If so, do you agree with the proposed definition? If not, please explain why.

Contingency funds

5.87 To improve investors' understanding of the role of contingency funds where they are legitimately offered by a P2P platform without authorisation as an insurer (in the circumstances described in paragraphs 4.66 to 4.71), we also propose two further disclosures, to be made to individual investors before they invest.

5.88 First, a requirement for the platform to have a prominent standard risk warning to make it clear to investors that the operation of a fund does not guarantee payment in the event of defaults. As explained in paragraph 4.71, if a platform wants to offer a guarantee to investors, it could consider buying insurance instead.

5.89 Secondly, a requirement for the platform to have a public policy made easily available to investors (for example, via the platform website) explaining:

35 Article 178 of Regulation (EU) No 575/2013

- how the contingency fund is funded
- how the contingency fund is governed
- who the money in the fund belongs to
- the considerations the fund/platform takes into account when deciding whether or how to exercise its discretion to pay out from the fund, including examples. This should include consideration of whether or not the fund has sufficient money to pay and that it has absolute discretion in any event not to pay or to decide the amount of the payment
- the process for considering pay outs from the fund
- a description of how that money will be treated in the event of the platform's insolvency

5.90 Once investors have invested, we propose to require platforms to notify them if they have received payments from the fund as a result of a defaulting loan. We also propose that, where a platform publishes information that contains an indication of past performance, that information does not include repayments made from a contingency fund as part of any presentation of net returns to investors (as this masks actual defaults).

5.91 Finally, we propose that platforms must publish, on a quarterly basis, certain facts about how the fund is performing, in particular:

- the size of the fund compared to total amounts outstanding on P2P agreements relevant to the contingency fund
- what proportion of outstanding borrowing under P2P agreements in default has been paid using the contingency fund.

Q23: Do you agree with our proposals to require disclosure of information about contingency funds? If not, please explain why.

Q24: Are there other measures that we should consider to address the harm that can arise from contingency funds obscuring underlying risk 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)?

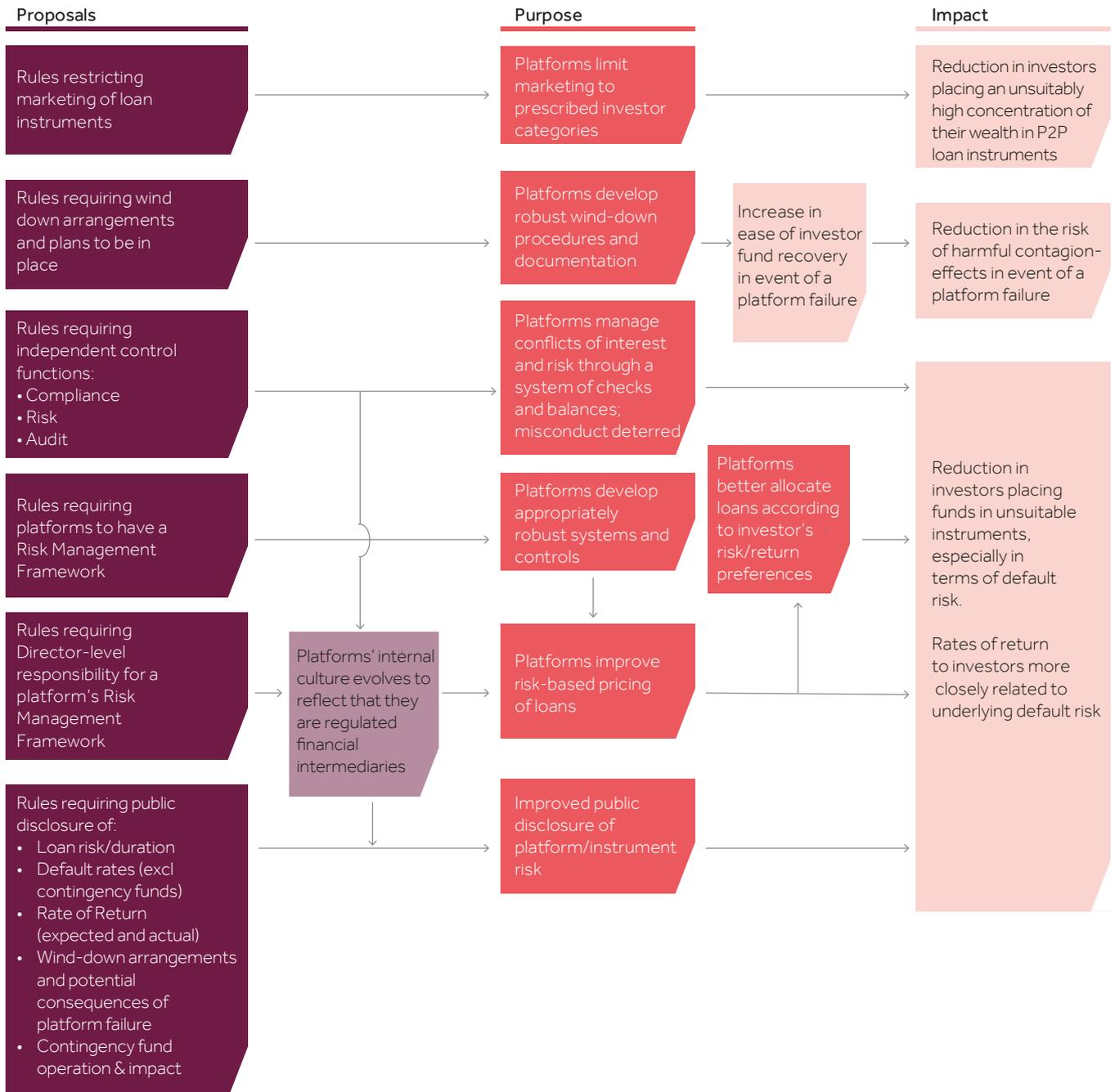
Commencement arrangements

5.92 To give P2P platforms time to make any necessary adjustments we propose a commencement period. We propose that these new rules should come into force six months from publication of the final rules and Policy Statement. The proposed period reflects that the majority of our changes build on existing requirements and so platforms should already have at least some of what is required in place.



Q25: Do you agree with our proposal for a six month commencement period? If not, please explain why.

Causal Chain 1: Summary of proposals, purpose and intended impact



6 Questions raised by investment-based crowdfunding platforms

- 6.1** In this section, we discuss our rules in relation to investment-based crowdfunding platforms, with particular reference to:
- The previously proposed 'pooled investment vehicle' definition for the marketing restriction rules on non-mainstream pooled investments (NMPI) in COBS 4.12
 - The assessment of an investor's certified status required under COBS 4.7.7-10R
- 6.2** Our PIR has indicated that there is some confusion as to how these rules apply in practice.

'Pooled investment vehicle' definition for the marketing restriction rules on Non-mainstream pooled investments

- 6.3** In June 2016 we consulted on changes to clarify the application of the non-mainstream pooled investments (NMPI) rules.³⁶ The consultation was triggered because we had reasons to believe that the current Handbook Glossary definition of 'special purpose vehicle' (SPV) may have been interpreted by a number of platforms as implying a significantly narrower scope than intended when we introduced rules restricting the promotion of NMPI.³⁷ Therefore, this could result in a failure to secure the level of investor protection that was originally intended.
- 6.4** In the consultation, we set out our intention to capture pooled investments or 'funds' characterised by unusual, speculative or complex assets, product structures, investment strategies and/or terms and features. We did not intend to capture companies which have a general commercial or industrial purpose. To achieve this, we proposed a new 'pooled investment vehicle' definition.
- 6.5** We understand from the feedback received during our PIR industry engagement that some investment-based crowdfunding platforms are concerned that the proposed definition could impact their business models. We are aware that a number of these platforms currently operate using a structure which holds an asset in a vehicle which issues shares that are subsequently offered to investors. The vehicle owns, and sometimes manages the underlying assets. Any returns on the assets are distributed to investors pro rata based on the amount they have invested for example, via dividends.
- 6.6** Since we consulted the broader regulatory environment has changed. For example, as a result of MIFID II, a number of other requirements now apply to the selling of transferable securities, which may be applicable in the context of consumers investing

³⁶ Quarterly Consultation Paper 16/17 – Chapter 8 <https://www.fca.org.uk/publication/consultation/cp16-17.pdf>

³⁷ See CP12/19 Restrictions on the retail distribution of unregulated collective investment schemes and close substitutes (August 2012) and PS13/3 Restrictions on the retail distribution of unregulated collective investment schemes and close substitutes – feedback to CP12/19 including final rules (June 2013)



in pooled vehicles. We need to consider the appropriate scope of the definition in that wider context.

6.7 We will reconsider the issue, and if appropriate undertake a further consultation.

Assessment of an investor's certified status

6.8 In 2014, we amended the marketing restrictions in relation to the promotion of non-readily realisable securities (NRRS) which are relevant to for investment-based crowdfunding platforms . These restrictions prohibit firms from marketing direct offer financial promotions relating to NRRS to potential investors, unless they fall within one of the below categories:

- retail clients who are certified or self-certify as sophisticated investors
- retail clients who are certified as high net worth investors
- retail clients who confirm before a promotion is made that, in relation to the investment promoted, they will receive regulated investment advice or investment management services from an authorised person
- retail clients who certify that they will not invest more than 10% of their net investible portfolio in unlisted shares or unlisted debt securities (ie excluding their primary residence, pensions and life cover)

6.9 During our PIR we have become aware that there may be some confusion amongst investment-based platforms in particular about the level of checks required in relation to an investor's certification, particularly in relation to high net worth investors.

6.10 The rules that relate to marketing restrictions NRRS (COBS 4.7.9R) cross refer to the rules that relate to marketing restrictions for NMPI (COBS 4.12.6R). This cross reference has generated confusion as some market participants are unclear as to whether the guidance that applies to NMPI rules (COBS 4.12.9G) also applies to NRRS. We would like to clarify that such guidance does apply to both NMPI and NRRS, as a result of the above-mentioned cross reference.

6.11 The guidance contained in COBS 4.12.9G states that a firm wishing to rely on any of the 'certified high net worth investor' exemptions should take reasonable steps to ascertain that the retail client meets the requirements of the 'certified high net worth investor' criteria.

6.12 We have been asked whether these requirements mean that platforms must always collect documentary evidence that allow them to verify underlying salary or other income to meet the 'reasonable steps' test. We are aware that platforms do not routinely collect such supporting evidence, and platforms tell us that new customers are unlikely to want to volunteer such information in the context of business largely conducted online.

6.13 We are not proposing to prescribe what specific checks or evidence gathering a platform must undertake. There are a number of ways in which a platform can take reasonable steps. In designing their processes platforms should consider what



constitutes a meaningful self-certification in the context of the business model and the type of interaction they have with the underlying customer. For example, we accept that for many platforms it may not be reasonable to check investors' payslips to evidence their net worth, but there may be some circumstances where a platform concludes this is appropriate. However, a process that could lead to a customer inadvertently making an inaccurate certification would not be sufficient.



7 P2P platforms: mortgages and home finance

7.1 In this chapter, we explain our proposals in relation to mortgages and other home finance facilitated by P2P platforms.

Context

7.2 There is currently no UK P2P market for regulated home finance. As set out in our 2016 Call for Input, however, we are aware that some P2P platforms are considering moving into residential secured lending. If they did this, we think that they would be likely to be carrying on the regulated home finance arranging activity. They would, therefore, be subject to parts of our Mortgage and Home Finance: Conduct of Business sourcebook (MCOB) rules and other FCA Handbook rules.³⁸

7.3 However, the business models of these P2P platforms might mean that nobody has responsibility for the regulated home finance lending or providing activity. This is because it would be possible for a P2P platform to facilitate a home finance product where some or all of the investors are not required to be authorised as home finance providers.³⁹ In these circumstances, our MCOB rules applicable to mortgage lenders or home finance providers would not apply to those investors. We are concerned that home finance customers who transact via a P2P platform might not always receive a similar level of consumer protection that they would if the finance provider was authorised.

7.4 To address this we propose that, where a P2P platform facilitates home finance products and at least one of the investors is not required to be authorised as a home finance provider, the platform must comply with our MCOB rules and other Handbook rules which apply to firms carrying on the regulated home finance lending or providing activity. We also propose some limited modifications and exceptions to these rules to reflect the specifics of the P2P business model.

7.5 We refer to P2P platforms that facilitate home finance products where at least one of the investors is not authorised as a home finance provider as 'home finance platforms' for the rest of this chapter.

7.6 Our proposed approach to home finance platforms reflects our existing approach in other markets. P2P platforms facilitating P2P credit agreements are already subject to rules under our Consumer Credit sourcebook (CONC). These include rules on assessing creditworthiness (including affordability), pre-contract explanations and arrears notices. This ensures that basic borrower protections apply even if the investor is not engaged in regulated lending and so is not subject to CONC and the Consumer Credit Act (CCA).

38 In this chapter, reference to rules includes, where appropriate, reference to any associated guidance.

39 This would be where the investor is not acting by way of business.

- 7.7** Our proposals plan to apply our non-Mortgage Credit Directive (MCD) MCOB rules, which apply to authorised home finance providers, to home finance platforms. We are aware that P2P agreements could arise where one or more of the investors is itself authorised as a home finance provider. In that scenario, the investor(s) in question will still be responsible for meeting their obligations, including any applicable MCD as well as non-MCD MCOB rules. It would be open to them to satisfy those obligations by outsourcing to the P2P platform.⁴⁰
- 7.8** P2P platforms may also be subject to certain CONC rules when they facilitate certain home finance products. To eliminate any potential duplication when we apply our MCOB rules to home finance platforms, we are proposing to disapply any applicable CONC rules. This is because we are of the view that P2P home finance customers will be better protected by measures that are tailored to the risks and features of home finance.
- 7.9** In cases where the mortgage contract is outside the scope of the MCD, we are proposing to disapply the MCD MCOB rules which are applicable to home finance arrangers. For example, where the investor is not acting by way of business or the mortgage is MCD-exempt. This will allow a home finance platform to take into account only the non-MCD MCOB rules.
- 7.10** In developing these proposals we have tried to prevent possible harm to customers of home finance platforms, but in a proportionate way that is consistent with our existing rules for other home finance providers. We also consider that, by increasing customer confidence, the proposals would support the development of this market in the future.
- 7.11** We have set out below a summary of the rules that we propose to apply to home finance platforms.

Proposals

Responsible lending and financing

- 7.12** MCOB 11 requires mortgage lenders and home purchase plan providers to assess whether a customer is able to afford the sums due under a regulated mortgage contract or home purchase plan prior to entering into it or making a variation to its terms. This is to protect customers from irresponsible or unfair lending practices.
- 7.13** At present, it may be possible for P2P platforms to offer home finance products to customers without these protections in place. This increases the risk of the customer falling into arrears, which can result in them losing their home. We therefore propose to apply the responsible lending and financing rules to home finance platforms to prevent such harm and ensure customers are protected to the same standards as other home finance customers.
- 7.14** We also propose to apply the alternative provisions in MCOB 11 for particular forms of lending (for example, lending to high net worth borrowers, business loans, interest-only mortgages and bridging finance) to home finance platforms.

⁴⁰ See also SYSC 8.1.6 on outsourcing regulatory obligations.



Q26: 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?

Treatment of customers with a payment shortfall

- 7.15** Our MCOB 13 rules on arrears, payment shortfalls and repossessions apply to mortgage lenders and administrators and the equivalent for home purchase plans.
- 7.16** These provisions help ensure customers with a payment shortfall are treated fairly and provide additional protections for vulnerable customers and those at risk of repossession. Customers considering taking out a home finance product via a P2P platform may do so because they are unable to access home finance elsewhere, which could leave them particularly vulnerable to harm if adequate safeguards are not in place.
- 7.17** We therefore propose to apply these rules to home finance platforms to ensure that their customers receive these protections.
- 7.18** One of our rules we propose to apply is the requirement to have a written policy in place to ensure compliance with MCOB 13. This is in addition to our default rate requirements proposed in Chapter 4, as those aim to improve outcomes for investors rather than home finance customers.

Q27: 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?

Disclosure

- 7.19** Our disclosure rules ensure customers receive information regarding their home finance product at various stages in the sales process and during the term of their contract. This allows customers to understand a firm's service and products. It also ensures customers are kept informed about their product throughout its lifetime.
- 7.20** As our rules currently stand, a P2P home finance customer may not benefit from receiving the same disclosures which other home finance customers would receive. For instance, disclosure at the offer stage and post-contractual disclosure rules (MCOB 6 and 7 respectively) apply to the home finance provider. As a result a home finance customer transacting via a P2P platform might not receive these disclosures. We are therefore proposing to amend our rules to make the home finance platform responsible for providing customers with specific disclosures required in MCOB. This includes:
- disclosure at the offer stage detailing the specific home finance product to be entered into by the customer, in addition to a tariff of charges (MCOB 6)
 - a disclosure document to be issued prior to the taking of the first payment under the home finance product (where required) detailing payment information (MCOB 7.4)
 - annual statements (MCOB 7.5)
 - event-driven disclosures (MCOB 7.6), and

- where relevant, the tailored disclosure rules for other forms of home finance

Q28: 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?

- 7.21** We have identified aspects of our disclosure rules which are not suitable for home finance platforms, because they require information to be given to customers which would not be relevant in the circumstances. We are, therefore, also proposing some minor modifications to MCOB 4 and MCOB 5.
- 7.22** Under MCOB 4.4A.1R, a firm must provide a description of its services. This includes whether there are any limitations in the range of products it facilitates from within each relevant market, and if so, what those limitations are. We do not anticipate that the majority of home finance platforms would want to arrange home finance products outside those available on its own platform. We therefore propose to introduce a new rule allowing home finance platforms to offer a plain language description of the scope of services it provides.
- 7.23** Home finance platforms will still be expected to disclose the basis of their remuneration and adhere to other rules applicable to intermediaries in MCOB 4.
- 7.24** We are also proposing minor amendments to MCOB 5 so that a home finance platform does not have to disclose the identity of the investor(s) in the Key Facts Illustration (KFI). Instead we propose to allow home finance platforms to explain that the loan is to be taken out via the platform with a description of the type of the investors. We are also proposing to allow this in the offer document.
- 7.25** We are also proposing to modify the application of MCOB 5 so that when the KFI is issued by or on behalf of a separate mortgage intermediary, reference should be made to the P2P platform rather than the lender(s).
- 7.26** We also propose that home finance platforms should have the option to disclose product information via a European Standardised Information Sheet (ESIS) rather than a KFI, and to use an annual percentage rate of charge (APRC) figure rather than an annual percentage rate (APR) as a cost of comparison tool. Where an investor is an MCD creditor, that investor would be required to provide the ESIS and use an APRC in any case.

Q29: 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?

Other MCOB rules

- 7.27** We propose to apply a number of other relevant MCOB rules to home finance platforms. They include:
- **Charges (MCOB 12):** rules regarding fees and charges imposed on a customer, including early repayment and payment shortfall charges



- **Annual Percentage Rate (APR) (MCOB 10 or 10A):** method for calculating the APR or, if the P2P platform so chooses, the APRC associated with a home finance product⁴¹
- **Conduct of business (MCOB 2):** general conduct rules
- **Financial promotions (MCOB 3A):** rules governing how a firm communicates financial promotions to home finance customers

Q30: 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?

Data reporting

7.28 Under Chapter 16 of the Supervision manual (SUP 16), home finance product providers are required to provide us with a range of data on their lending activities. These data are used to help us identify and assess risks in financial markets (for example, irresponsible lending and other potential consumer harm) and supervise efficiently and effectively.

7.29 We, therefore, propose to apply our full suite of reporting rules to home finance platforms. These differ depending on the type of home finance in question, but can include:

- **Product Sales Data (PSD)** – including transaction level sales data on all home finance products entered into via the platform within the reporting period and data on the performance of back-book transactions. Firms are required to report sales data to us every quarter and performance data every 6 months.
- **Mortgage Lenders and Administrators Return (MLAR)** – aggregated data returns covering a firm's home finance administration and providing activities. Firms are required to report these to us on a quarterly basis.
- **Retail Mediation Activities Return** – data on the provision of intermediary services. Firms are required to report at least twice yearly.

7.30 Without these data we would rely on alternative methods of monitoring this type of activity, such as ad hoc data requests and supervisory work. In other contexts, these have proven to be time and resource intensive for both us and firms.

Q31: 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?

⁴¹ Where an investor is an MCD creditor, that investor would be required to comply with MCOB 10A requirements in any case.

Other issues

7.31

There are a number of areas of our Handbook that relate to platforms facilitating regulated home finance products where we do not propose to make changes. These include:

- **Prudential:** The application of prudential rules is determined by the permission that the platform has. We are not proposing to amend the requirements to make home finance platforms subject to the same prudential rules as home finance providers. P2P platforms are likely to be subject to a number of controls, determined by whether they are carrying out regulated activities including arranging, or administering. For example, arrangers must hold professional indemnity insurance. P2P platforms will also be subject to controls if they hold client assets.
- **Fees:** We are not proposing to amend the fee blocks for home finance platforms. This means that P2P platforms arranging home finance will continue to fall within the A18 block, where they will report all their income related to home finance intermediation. Meanwhile, P2P platforms administering home finance will pay fees in the A2 block, based on the number of contracts they manage.
- **Training and Competence:** P2P platforms that provide advice on home finance products need to ensure that staff are adequately qualified to do so in line with the rules in our Training and Competence manual.

Q32: Do you have any comments on the application of our other (ie not MCOB) rules to platforms facilitating home finance products, where one or more of the investors is not an authorised home finance provider?



Annex 1

Questions in this paper

- Q1:** Do you have any comments on our assessment of the equality and diversity considerations?
- Q2:** Do you have any comments on the description of the business models in this section?
- Q3:** Do you have any comments on the analysis of harm in this section?
- Q4:** 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 structured way, and
 - c) price the loan so it adequately and fairly reflects the credit risk determined in a)? If not, please explain why.
- Q5:** 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?
- Q6:** 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?
- Q7:** 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.
- Q8:** 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.

- Q9:** Do you agree that a P2P platform's risk management framework must be adequate to assess price and value over time, ie for newly originated and, for example, for loans that have defaulted? If you do not agree, please explain why.
- Q10:** 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 agreements on behalf of investors?
- Q11:** 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?
- Q12:** 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?
- Q13:** Do you agree with our proposals to apply marketing restrictions to P2P platforms? If not, please explain why.
- Q14:** Do you agree with the proposed modification to the systems and controls rules regarding wind-down arrangements? If not, please explain why.
- Q15:** 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?
- Q16:** Have we correctly identified the information that should be included in the P2P resolution manual? If not, what other information should be included?
- Q17:** 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?
- Q18:** Do you agree with our proposals to clarify the information that a P2P platform should provide regarding its role?



- Q19:** 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?
- Q20:** 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 explain why.
- Q21:** 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?
- Q22:** Do you agree with standardising the definition of default? If so, do you agree with the proposed definition? If not, please explain why.
- Q23:** Do you agree with our proposals to require disclosure of information about contingency funds? If not, please explain why.
- Q24:** Are there other measures that we should consider to address the harm that can arise from contingency funds obscuring underlying risk 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)?
- Q25:** Do you agree with our proposal for a six 6-month commencement period? If not, please explain why.
- Q26:** 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?
- Q27:** 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?
- Q28:** 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?

- Q29:** 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?
- Q30:** 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?
- Q31:** 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?
- Q32:** Do you have any comments on the application of our other (ie not MCOB) rules to platforms facilitating home finance products, where one or more of the investors is not an authorised home finance provider?
- Q33:** Do you have any comments on our cost benefit analysis for the proposals arising from the post-implementation review?
- Q34:** Do you have any comments on our cost benefit analysis for the P2P mortgage and home finance proposals?



Annex 2

Cost benefit analysis

Introduction

1. Section 138I of the Financial Services and Markets Act 2000 (FSMA) requires us to publish a cost benefit analysis (CBA) alongside our proposed rules. A CBA is 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made' and 'an estimate of those costs and of those benefits'. If, in our opinion, the costs or benefits cannot reasonably be estimated or it is not reasonably practicable to produce an estimate, the CBA need not estimate them; where that is the case, we must state our opinion and given an explanation of it.
2. Section 138L(3) of FSMA provides that we are not required to publish a CBA if we consider that there will be no increase in costs or, if there is an increase, the increase will be of minimal significance.

P2P platforms: proposals arising from the post-implementation review

Market failure analysis

Harms identified

3. Our post-implementation review has identified a number of potential harms to investors arising from the services that a platform provides and the level of discretion it may exercise on behalf of its investors. We explain these harms in more detail in Chapter 4 of the CP, but to summarise we are concerned that investors may be affected by the following poor outcomes:
 - remuneration levels are not aligned with the underlying risk
 - excessive costs of the services provided by platforms
 - purchase of unsuitable financial products, in particular when consumers unwittingly take up excessive risk
 - decrease in confidence in crowdfunding and in financial markets following potential disorderly wind-down of platforms and, relatedly
 - harmful side-effects if failure results in contagion effects to other platforms

4. We analyse in this section the economic drivers of such harms for P2P crowdfunding platforms, namely:
 - information asymmetries: this can arise when investors do not have access or cannot properly understand key features of the proposed products and services, including costs they are paying, risk of the proposed investment, and what may happen in the event of platform failure
 - misaligned incentives between platforms and investors
 - behavioural biases which affect investors' perception of risk and prospective returns.
5. **Information asymmetries**
Where a platform operates any of the following services, investors are likely to know significantly less than the platform about these offerings and how they operate in practice:
 - sets the price of a loan
 - chooses the investor's portfolio to generate a target rate
 - shuffles loans between investors
 - offers a discretionary contingency fund to top up payments if a borrower defaults
6. As such, investors may find it difficult to assess the true nature and risk of the underlying investment or indeed whether it provides value for money. This could be for a number of reasons, set out below.
7. The necessary information needed to fully understand the risks involved is not made available or, if it is made available, investors' expertise may not be sufficient to understand the complexity of the investment arrangement. Due to the complexities of the models operated by some platforms, it may not be reasonable to expect all retail investors to understand the risks involved.
8. Platforms might sometimes have commercial incentives to provide biased information to investors. We have found that platforms' communications might give investors the impression that their investments are highly liquid or nearly risk-free, and they might downplay the extent to which investors' net returns are pooled with those of other investors.
9. In addition, the industry has a collective incentive to improve wind-down planning to maintain or improve investor confidence in the sector. However, at an individual platform level there is likely to be little commercial incentive for platforms to invest in adequate wind-down plans or to disclose to investors the potential consequences for their investment in the event of platform failure. This is the result of: i) the impact on the performance of the investment, ii) the impact on the servicing of the P2P arrangement, and iii) any potential changes to investor protections that may arise. Therefore, consumers are unable to take wind-down planning into account in making investment decisions.
10. **Misaligned incentives**
Additionally, platforms have incentives to facilitate loans that expose investors to excessive risk, as the costs of default are borne by investors. That is to say, their



decisions impose costs that are not borne and hence internalised into their choices on access for borrowers to platforms and investors' funds. For example, some platforms have their business models set up in a way that means they offer investors a maximum target return. In some models, if the loans investors are exposed to pay more than such maximum target return, the platform will retain the differential. This creates incentives for platforms to expose investors to riskier loans given that platforms may benefit from returns being higher than those advertised, but they will not bear downside risk. A platform may also receive ancillary fees, for example when a payment is late.

11. In general, platforms do not appear to lend off their own balance sheet. As they facilitate loan arrangements, they effectively act as agents who on behalf of lenders (the 'principals') perform, for example, certain due diligence on prospective borrowers and demonstrate the robustness of their processes. However, platforms also have competing commercial incentives to:

- maximise the volume of borrowers as the demand from investors grows
- avoid liability by minimising the concrete commitments they make in their promotions regarding their due diligence

12. Furthermore, some platforms offer pre-funded loans (arranged by either the platform itself or by a related company). This exacerbates the possibility that platforms' incentives are not aligned with those of the investors, as they may seek to place these loans as rapidly as possible. This may increase the risk that consumers acquire investments that are not suitable for their needs.

Behavioural biases

13. Framing effects may have significant impacts on choices. Some investors are likely to act on the basis of headline returns without due consideration to risks in relation to investment options. Even net returns across a platform's loan-book might be misleading to investors insofar as the risk profile of their own portfolio differs from the total loan book. They might also underestimate the level of default or delinquency among older loan cohorts, especially if the platform's loan-book is growing quickly. Another behavioural phenomenon, over-extrapolation, may lead consumers to believe that previous perceived success in achieving satisfactory returns indicates low risk in relation to future investments in the same platform or in the crowdfunding sector as a whole.

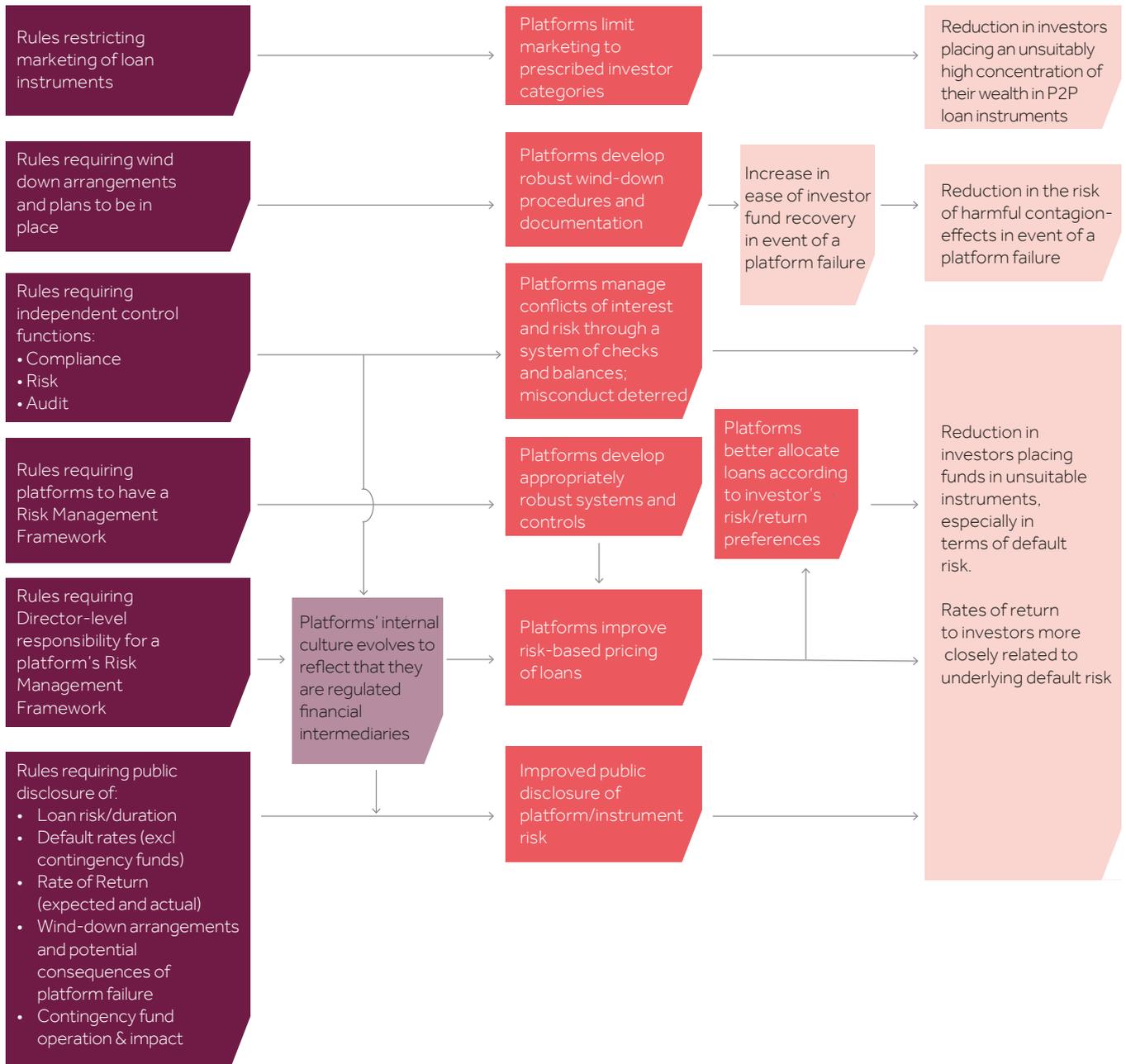
Cost benefit analysis

14. We are consulting on new rules for platforms operating loan-based crowdfunding platforms (P2P) in five main areas:

- risk management framework
- governance arrangements
- marketing restrictions
- wind-down arrangements
- disclosure

15. The costs and benefits are presented separately for each proposal. We consider the incremental costs and benefits that will occur as a result of our proposals, relative to a situation where the proposals are not implemented. We assume compliance with existing requirements as baseline for our CBA. Where we give figures taken from prior CBA work, these have been adjusted for inflation and reported below in current prices.¹
We welcome feedback on our CBA approach and conclusions from consultation respondents.

Casual Chain 1



1 Using Retail Price Index. www.ons.gov.uk/economy/inflationandpriceindices/timeseries/chaw/mm23



Key facts and assumptions

- 16.** Our proposed new rules and guidance for the P2P sector build on existing high level rules, which are explained in each section discussed below, and make clear our expectations of how the required standards should be upheld in this sector.
- 17.** We have seen good and poor practices within the sector. Many of our proposals seek to reinforce existing high level rules and guidance and set a minimum standard to address poor practices where we have seen this. We only calculate costs on the basis of a compliant platform. As such, where platforms are already operating to existing expected standards, the cost to those platforms will be of less significance.
- 18.** We expect approximately 63 P2P platforms to be affected by our proposals to varying degrees. This figure is based on the number authorised P2P platforms at the time of writing the CP.
- 19.** We recognise that this is a growing market and more platforms may be affected by the rules in the future. However, consolidation in the sector is also possible in future. In this CBA, where possible to do so, we estimate the costs per platform and the total cost to the industry based on the current population of authorised platforms. As this is still a relatively new sector, we expect that the evolution of a diverse range of business models that we have observed among P2P platforms will continue, as platforms become more experienced in operating in a financial services environment.
- 20.** Proportionality is built into our existing systems and controls rules as adequate compliance depends on the nature, scale and complexity of the business model being operated by the platform. Therefore, larger and more complex platforms should already have in place effective systems and controls appropriate to their business. In the same way, many of our proposals will impact platforms differently, depending on the services they offer and the size of their business. There are some parts of the proposed rules where platforms will have varying implementation options (for example, build better risk management systems or simplifying their business) with differing cost implications. In general, we are providing a qualitative rather than quantitative view of the costs and benefits for these, because it would not be reasonably practicable to produce an estimate or reliable to make assumptions about platforms' choices across the industry.
- 21.** We are not banning any types of service, but recognise that in setting minimum standards some platforms may wish to modify their business models away from the more complex services that we have observed in recent years.
- 22.** Proposals will be subject to a 6 month commencement period, to allow platforms to modify their business models should they wish to do so ahead of the introduction of new rules.

Table 2

Model	Predominant Platform Type	Features and implicit expectations	Est. % of P2P platforms	Est. % of market
Conduit	P2P And Investment-based	<ul style="list-style-type: none"> Platform undertakes due diligence on person/business seeking investment and decides whether to offer them + <ul style="list-style-type: none"> Investor <u>responsible</u> for choices made about the prospect of a good return on individual loans/investments 	20%	4%
Pricing	P2P	<ul style="list-style-type: none"> Platform undertakes due diligence on person/business seeking investment and decides whether to offer them + <ul style="list-style-type: none"> Platform is responsible for accurately pricing loan (ie calculates the likely return) + <ul style="list-style-type: none"> Investor responsible for choices made from platform's <u>advertised interest rates</u> for individual loans 	20%	8%
Discretionary	P2P	<ul style="list-style-type: none"> Platform undertakes due diligence on person/business seeking investment and decides whether to offer them + <ul style="list-style-type: none"> Platform is responsible for accurately pricing loan (ie calculates the likely return) + <ul style="list-style-type: none"> Investor chooses from platform's <u>advertised target rates of return</u> + <ul style="list-style-type: none"> Platform allocates investment on behalf of investor to achieve advertised target rate of return 	60%	88%

Note: The figures in this table for the percentage of P2P platforms and market share by business model are estimates only. These estimates are based on cumulative lending figures from a sample of authorised firms. Some platforms may also operate more than one business model. The estimates exclude platforms with an interim permission.

Costs

23. In the section below, where possible to do so we have estimated the number of platforms that we expect to be impacted by our proposals. To do this we have used the total number of platforms authorised for the regulated activity 'operating an electronic system in relation to lending', of at the time of writing, ie 63, and the estimated percentages of platforms in the Table 2 above. Some platforms operate more than one model, where this is the case some double counting may occur where our proposals impact more than one of the models described in Table 2.



Risk Management Framework

- 24.** Under our proposals, for those platforms that set the price of a loan (Pricing and Discretionary, approximately 50 platforms), we propose to require them to have a risk management framework in place 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 (ie the probability of default and loss given default)
 - b.** categorise borrowers by their credit risk in a systematic and structured way
 - c.** price the loan so it adequately and fairly reflects the credit risk determined in a)
- 25.** The risk management framework should be appropriate for the complexity of the platform's business model and the type of lending facilitated. We have intentionally not sought to prescribe the different types of models or methodologies a platform may use due to the diversity of business models active in the sector.
- 26.** If a platform is offering investors a target rate of return for a portfolio of loans (the Discretionary business model, approximately 38 platforms), it is acting as a decision maker, exercising discretion on behalf of investors. The platform should have a reasonable basis to conclude that, at all times, what it is advertising to investors can be reasonably achieved.
- 27.** Platforms should also ensure that investors are only exposed to the risk parameters advertised at the time of investment. There are already existing requirements for P2P platforms to ensure their communications are fair, clear and not misleading², so they should already have systems and controls in place to support their disclosures and financial promotions.
- 28.** Platforms must ensure that their risk management framework is adequate at all times (including monitoring its effectiveness, taking appropriate action to address deficiencies, and maintaining records of each transaction for which the framework has been used).
- 29.** Platforms must ensure that where they facilitate an exit for a lender before the maturity date this is done at a fair and appropriate price. However, platforms may also need to re-value loans more frequently as part of the disclosure requirements, for example where the loan has defaulted.
- 30.** All platforms are already subject to our general requirements in the Principles for Businesses³ (PRIN), and Senior Manager Arrangements, Systems and Controls⁴ (SYSC) sourcebooks. As such, they should already have appropriate systems and controls in place to support the services they offer. This means that if a platform's business model consists of arranging and pricing loans, it will be unlikely that such a platform could argue that it has effective systems and controls in place if it does not conduct credit risk analysis of the loans it arranges. However, our proposals build on these and explicitly require credit assessment and a risk management framework.

² www.handbook.fca.org.uk/handbook/COBS/4/2.html

³ www.handbook.fca.org.uk/handbook/PRIN/1/?view=chapter

⁴ www.handbook.fca.org.uk/handbook/SYSC/1/1A.html

31. Our more detailed proposals reinforce the existing requirements on firms to have robust governance arrangements in place⁵, to conduct its business with due skill, care and diligence and take reasonable care to organise and control their affairs responsibly and effectively, with adequate risk management systems.⁶ They are designed to set more explicit granular standards, to improve consistency and rigour within the P2P sector.
32. We estimate a maximum of 50 out of the 63 authorised P2P platforms will be impacted by this proposal. However, these platforms will be impacted in different ways depending on the precise nature of the services they offer and the governance structures and systems and controls they already have in place.
33. Information gathered as part of our authorisations and supervision work on the P2P sector indicates that most P2P platforms will be subject to CONC requirements in respect of at least some of the agreements they offer. P2P platforms facilitating P2P agreements where the borrower is an individual (including a small partnership or unincorporated body which does not consist entirely of bodies corporate and is not a partnership), will already be subject to detailed creditworthiness rules in CONC, and in CP17/27 we consulted on proposals which (among other things) envisaged new rules on P2P platforms' policies and procedures for creditworthiness assessment. The proposed CONC requirements include record-keeping rules. If a platform is required to do a creditworthiness assessment under CONC rules, or our proposed affordability assessment under MCOB rules (see Chapter 7), it will already gather information to consider affordability for the borrower. Our proposed rules apply such that a platform having complied with one of these requirements will have gathered sufficient information about the borrower to be able to determine the borrower's credit risk (ie probability of default and loss given default), even though it will need to use that information for a different purpose, ie to consider the interests of the investor rather than the borrower.
34. **Costs:** As mentioned above, all platforms should already have appropriate systems and controls in place to support the services they offer. As such, we think it is likely that compliant platforms will only need to make small to moderate adjustments to their existing arrangements to meet the standards required by these proposed rules. However, we do not think it practicable to quantify the cost of complying with these proposed rules. Impacts will depend on a number of circumstances that we are not in a position to establish, such as:
- the specific activities undertaken by a platform
 - the underlying asset classes (for example, SME finance, consumer credit and property finance) and repayment schedules (for example, 'bullet' or amortising structures)
 - the methodology adopted by platforms to determine target rates of return advertised to investors, which will be specific to the circumstances of individual platforms (for example, depending on whether it facilitates a large number of homogeneous loans or fewer and/or more heterogeneous loans, or whether the platform facilitates consumer or business lending)

5 SYSC 4.1.1R

6 PRIN 2.1R



- any additional services that platforms may offer (such as contingency funds or secondary market)
- the multiple options platforms may choose in terms of how to comply with our proposed requirements (for example, adapting business models and/or upgrading their control environment)

Governance arrangements

- 35.** We propose to reinforce the importance of the risk management framework, by requiring responsibility for it to be held by a senior approved individual. In addition, and depending on the nature, scale and complexity of a platform's business, independent control functions (for risk, compliance and internal audit) will be required to ensure an appropriate level of independent checks and balances within the platform.
- 36.** These proposals build on the high level rules already in place to:
- have clear lines of responsibility, robust governance arrangements and effective processes to identify, manage, monitor and report the risks that a platform may be exposed to⁷
 - ensure compliance of the firm with its obligations under the regulatory system⁸ and
 - competent employees⁹
- 37.** First, as with the proposals for the risk management framework, we estimate approximately 50 out of the 63 authorised P2P platforms will be impacted by the proposal for P2P platforms to allocate operational oversight of the risk management framework to a senior approved person (such as an executive director). We expect the cost of compliance to be minimal in most cases, as we expect a platform that prices and allocates investments on behalf of the investor to already have in place competent staff to perform and oversee such a function under existing high level rules. Therefore, this proposal will involve platforms reviewing their current arrangements to see if the allocation of responsibility of the system in place to credit assess and value loans is clearly and appropriately assigned at a senior level, and making any necessary adjustments as a result.
- 38.** Secondly, the requirement to have independent control functions in place recognises that platforms of a certain size and complexity should have independent functions to ensure conflicts of interests do not arise with operational areas of the business. With reference to Table 2, we estimate approximately 38 of the 63 authorised P2P are operating the Discretionary business model. These platforms, that set the price and choose the investor's portfolio to generate a target rate, are operating models where they are exercising discretion on behalf of investors, and it is our view that the larger of these platforms are likely to be complex enough to require independent risk and internal audit functions.
- 39.** The above, and associated provisions, currently apply to peer-to-peer platforms as guidance.¹⁰ Therefore, our proposal is to alter the status of these, and related,

7 SYSC 4.1.1R

8 SYSC 6.1.1R

9 SYSC 5.1.1R

10 SYSC 6.1.3AG, SYSC 6.2.1AG and SYSC 7.1.7AG

guidance provisions to rules, in order to set specific obligations. Platforms will be impacted by this proposal to varying degrees depending on the governance structure they already have in place.

40. The FCA Approved Persons¹¹ regime requires the people responsible for these independent functions to be pre-approved by us. As such, this proposal may result in some additional people being brought within the scope of the Regime, and require our approval to perform these roles. The number of individuals likely to require pre-approval by us for the Systems and Controls controlled function (CF28) will depend on the current governance structure of a platform. We estimate a maximum of 76 new approvals for the sector as a result, ie 38 Head of Risk and 38 Head of Internal Audit (2 new approvals per platform for a maximum of 38 platforms). But in practice we think this is likely to be significantly less (potentially in the region of 10 approvals for the sector), as some individuals allocated these responsibilities will already be approved. Compliance officers are already required to be pre-approved.¹²
41. **Costs:** We have used the survey data collected for the CBA for CP17/25 (Individual Accountability: Extending the Senior Managers & Certification Regime to all FCA firms) to estimate the one-off cost of allocating responsibility for the risk management framework to an approved senior manager to be around £3,710 and the ongoing cost as between £140 and £450.¹³ Therefore, for the sector the one-off costs are estimated to be £185,500, and ongoing costs between £7,000 and £22,500. This uses the cost of the 'allocation of overall responsibility' proposal under the Senior Managers Regime as a proxy.
42. We do not think it is practicable to quantify the cost of complying with the proposed requirement to have independent risk, compliance and internal audit functions, because the impacts are likely to be especially heterogeneous across different platforms for a number of reasons, such as:
- the specific activities undertaken by a platform, and
 - whether they have already complied with the governance standard, which applies to platforms currently as guidance (information from supervisory activities indicates that some larger platforms are taking account of existing guidance), and
 - the choices they make in response to the risk management framework proposals. For example, some platforms may choose to simplify their business models or enhance their controls
43. However, where a platform needs to submit an application for approval of either the Head of Risk or Head of Internal Audit functions as a result of our proposals, the average cost of applying for an approval is estimated to be approximately £83 based on the survey data collected for the CBA for CP17/25. As mentioned above, we consider that between 10 and 76 approvals will be needed. Therefore, the cost for the industry is estimated to be within the range of £830 – £6,308.

11 www.handbook.fca.org.uk/handbook/SUP/10A/?view=chapter

12 SYSC 3.2.8R and SUP 10A.7.8R

13 www.fca.org.uk/publication/policy/ps18-14.pdf



Marketing restrictions

- 44.** We propose to replicate the rules that apply to investment-based crowdfunding platforms and similar investment activities, prohibiting platforms from marketing directly to potential investors unless they:
- i.** certify or self-certify as sophisticated
 - ii.** certify as high net worth (has income of £100,000 or more or £250,000 or more in net investable assets)
 - iii.** confirm that they will not invest more than 10% of their net investable assets in these products, or
 - iv.** have received regulated advice.
- 45.** This rule does not currently apply to P2P platforms. Therefore, our proposals to restrict direct offer financial promotions for P2P agreements to certain types of retail client, and to require appropriateness checks to be undertaken for non-advised sales, will impact all P2P platforms.
- 46.** **Costs:** We have used the estimated incremental one-off and ongoing cost per platform used when consulting on these proposals for investment-based crowdfunding platforms (in CP13/13¹⁴), as we do not think these costs would be different for P2P platforms. Estimated one-off costs per platform are expected to be in the region of £3,300 on average, with minimal ongoing costs. As all 63 P2P platforms will be impacted the cost to industry as a whole is £207,900. Per platform, this consists of the costs from CP13/13, set out in paragraphs 48 and 49 below.
- 47.** We estimate that amending the systems and controls at these platforms to introduce or amend existing client certification and assessment processes will result in one-off costs of 5 days of web-based programming or equivalent, and 5 days of staff training per platform.
- 48.** We assume that the cost per day of a web programmer's time is £220 and that staff training will also cost on average £220 per day. So the total one-off cost per platform is £2,200 per platform, and £138,600 for the industry. We expect that the ongoing costs of implementing these proposals will be minimal as they mainly involve changes to online systems.
- 49.** With regard to the appropriateness checks, we envisage that platforms will design automated systems to assess client knowledge and experience, that can be incorporated into websites or back office processes. So, platforms will face one-off compliance costs in relation to IT systems changes. We estimate that this may involve one-off costs of 5 days of web-based programming or equivalent. We estimate a total initial cost of £1,100 per platform, and £69,300 for the sector. We estimate that the ongoing costs of implementing these systems will be small as they will mainly involve online systems or equivalent.
- 50.** It has not been possible to quantify the exact number of investors likely to be impacted by the restriction. Data from a survey of 4,500 P2P¹⁵ investors showed that 40% said

¹⁴ www.fca.org.uk/publication/consultation/cp13-13.pdf

¹⁵ Cambridge Centre for Alternative Finance

they had invested more than their total annual income and, of those, half had invested more than double their annual income. We can infer from this that a significant number of them are likely to be putting more than 10% of their net investible wealth into P2P lending.

51. P2P platforms (and borrowers) might find it more difficult to attract funds as a consequence of the 10% restriction, for two reasons. First, investment flows may be diverted away from P2P platforms and into other instruments. Secondly, the cost of borrowing funds via platforms may rise. However, we consider this is unlikely to be a significant cost (if at all) because market indicators show that P2P platform growth is currently limited by a lack of suitable borrowers, not by a lack of investors. In addition, some investors may be prevented from obtaining the maximum tax free allowance from the Innovative Finance ISA as a result of this proposal.
52. Offsetting these hypothetical impacts is the fact that investment flows diverted away from P2P platforms will flow into other instruments. This implies an increase in the supply of funds, and a reduction in their cost, in another part of the financial sector.
53. Given the data limitations, and the fact that the 10% marketing restriction is not expected to reduce aggregate investment per se but merely divert it to another part of the financial system, we do not think it is reasonably practicable to quantify the potential impact of the marketing restrictions, as we are not in a position to establish how much investment will move, and where to.

Wind-down arrangements

54. We already require platforms to take reasonable steps to ensure that they have wind-down arrangements in place.¹⁶ However, we propose a package of measures to clarify and reinforce the existing rules to ensure it is clear that platforms must have arrangements in place to ensure that P2P agreements facilitated by them will have a reasonable likelihood of being managed and administered in accordance with the contract if at any time it ceases to operate or carry out those functions itself.
55. We also propose further guidance explaining what platforms' arrangements might include in practice and what they may need to consider. For example, a platform may wish to consider whether it needs to obtain prior consent from investors to fund the cost of managing and administering the loans in a wind-down scenario.
56. Furthermore, we propose to require them to have a P2P resolution manual explaining the steps that would need to be implemented under the wind-down arrangements.
57. A P2P platform should already explain to investors what would happen if the platform fails under existing guidance.¹⁷ We propose making it a requirement that platforms must notify each investor of its wind-down arrangements before entering into a loan arrangement. This must include an explanation of the risks to the management and administration of loans in the event of the platforms failure including, for example, the possibility that P2P agreements may cease to be managed and administered before maturity.

16 SYSC4.1.8AR – SYSC4.1.8ER

17 COBS 14.3.7AG(10)



58. P2P platforms will need to consider, in light of the additional clarification and requirements, what changes may need to be made to their existing wind-down arrangements, disclosures and supporting documentation.
59. **Costs:** will differ according to how a platform complies with the existing requirement. For example, they could choose to have an in-house solution, or have a contract with a third party to step in and administer loans, and some may already have something similar to a resolution manual in place to support their wind-down arrangements. The size and complexity of the platform's business also has an impact. In CP13/13 we said we expect directors to review their processes for wind-down arrangements on a regular basis. We expect that platforms to consider the adequacy of their wind-down arrangements, taking into account the proposed new rules and guidance as part of their existing regular reviews, and make any necessary arrangements as a result. Our assumption from the CBA in CP13/13 is that it will cost £704 per day for a director to review a platform's arrangements, including the resolution manual, as part of their annual review. The number of days needed to conduct such a review will differ from platform to platform. In CP13/13 we estimated it would take one day to review a platform's arrangements, but taking account of the proposed requirements we now estimate that this could be in the region of 1 to 5 days, at a cost of £704 to £3,520 per platform, and £45,352 to £221,760 for the sector.

Disclosure

60. P2P platforms are already required to ensure their disclosures are fair, clear and not misleading and are already required to provide investors with a description of the nature and risk of the investment.¹⁸ Our proposals aim to reinforce this requirement by introducing specific rules to mitigate the risk that investors are not given the right information about the risks and costs they are exposed to.

Information about the role of the platform and the investment

61. P2P platforms are already required to ensure their disclosures are fair, clear and not misleading and are already required to provide investors with a description of the nature and risk of the investment. We are making our expectations of what this means in practice for P2P platforms clearer, by adding additional rules and guidance. For example, specific requirements to disclose:
- wind-down arrangements and to update these disclosures to investors should the circumstances or wind-down arrangements of the platform change
 - the nature and extent of the due diligence the platform undertakes in respect of borrowers
 - a description of how loan risk is assessed, including a description of the criteria that must be met by the borrower before the operator of the electronic system in relation to lending considers the borrower eligible for a P2P agreement
 - whether and what role the platform will play in determining the price of a P2P agreement
 - where investors do not have the choice to enter into specific P2P agreements, what role the platform will play in choosing P2P agreements for an investor

18 www.handbook.fca.org.uk/handbook/COBS/4/2.html

- where a platform offers a portfolio of loans to investors, what role it will play in composing that portfolio
- where the investor picks, details related to the P2P agreement itself such as the amount, risk categorisation (where required) and length of a loan
- where the platform picks, the range of risk categories (where required) and length of loans

62. We propose that a P2P platform must ensure that, at any point in time, its customers are able to access details of each P2P agreement they have entered into, such as:

- the annual percentage rate that will be paid by the borrower in respect of that P2P agreement
- the outstanding capital and interest payments in respect of that P2P agreement
- when the P2P agreement is due to mature
- any fees paid in respect of that P2P agreement by the investor or the borrower
- whether there has been a default by the borrower

63. Finally, where a platform sets the price, we propose that it must publish an 'outcomes statement' annually to show if it achieves what it advertises, including for example, where the firm offered a target rate, the actual return achieved.

64. All P2P platforms will need to review their additional disclosures to see where changes are needed as a result of these additional clarifications and requirements.

65. **Costs:** As a significant proportion of our proposals are clarification on existing Handbook provisions, we have used the disclosure costs in CP13/13 to estimate the likely cost impact on platforms. At that time, we said that we estimated a one-off cost per platform of: i) £1,848 for 2 days' training for compliance directors on the new rules (consisting of £88 per hour for a compliance director and £220 per day for a trainer), and ii) £9,240 for reviewing financial programmes and web programming over a period of 10 days (consisting of £88 per hour for a director and £220 per day for a web programmer). Applying these figures to the 63 platforms affected by our proposal, the cost to the industry is estimated to be approximately £700,000. We note that actual cost increases may be lower for some platforms, as there are platforms that currently disclose information in a way that is likely to be compliant with some or all of the proposed rules. On an ongoing basis, we expect disclosure to be reviewed regularly as part of business as usual processes, so ongoing costs should be minimal.

66. Disclosing the true cost charged to investors may make certain platforms' offering less attractive, with resulting consequences for the platforms. Clearer disclosures could lead to a shift in investment in favour of platforms/investment proposals offering better value for money.

Disclosures related to the function of contingency funds

67. We already expect platforms to explain to investors the nature of their contingency funds and any risks associated with these. Under our proposals, platforms will need to disclose certain information to prospective investors, for example:



- details about how the fund is operated and governed
- a standard risk warning to make it clear to investors that the operation of a fund does not guarantee payment in the event of defaults
- when investors have received payments from the fund as a result of a defaulting loan; and, on a quarterly basis
- certain facts about how the fund is performing

68. Our proposals will apply to platforms operating contingency funds or other similar schemes designed to top up loan payments in the event of delayed payments or defaults. Based on a snapshot of our Authorisations data from July 2016 we believe that approximately 30% of platforms in the market at the time operated contingency funds. This implies that 19 of the 63 platforms we assume will be active in the sector would be operating contingency funds. However, updated information now suggests that this number has significantly reduced with potentially very few platforms now operating such a fund.

69. **Costs:** We estimate, based on our judgement, that drafting the contingency fund disclosures should take 3 working days. Assuming a cost of £88 per hour for a compliance director to draft the text (based on the figures used in CP13/13) and a cost of £220 per day for a web programmer (again based on the figures used in CP13/13), this is expected to lead to a one-off cost of £2,772 per platform. For the whole sector this would be a maximum of £175,000. Ongoing costs are expected to be minimal and absorbed into the platform's regular ongoing reviews of its disclosures and financial promotions.

Benefits

70. The package of proposals in this CP will result primarily in benefits for P2P platforms and the investors that use them, by addressing the potential harms identified in our market failure analysis.

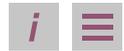
71. However, by reinforcing existing standards through new rules and guidance, increasing the likelihood of compliance, and bringing regulation of P2P more in line with the regulation of investment-based crowdfunding in certain areas, investor confidence in the sector as a whole may increase.

72. Our proposals aim to tackle information asymmetry and reduce the risk of people investing without understanding the nature of the risks they are taking.

73. We have not estimated the potential benefits quantitatively, as we do not think that it is reasonably practicable for us. To do so in a meaningful way would require extensive research and analysis which we do not consider to be proportionate. For example, we do not know the number of investors that will be impacted by the supply side marketing restriction as we do not have reliable data on the net investible wealth of investors in P2P lending. Nor do we have information about the choices that investors impacted by the marketing restriction would make as a result, ie what alternative financial instruments they choose to invest in. To obtain the necessary data and to delay

consultation to undertake such an analysis would delay the benefits to consumers we consider would arise, as described below, from our proposals.

- 74. Risk management framework:** Having a risk management framework that is capable of pricing loans and, in some cases, determining with reasonable certainty the expected rate of return of a portfolio of loans has the following benefits:
- reduction in mispricing of risk as the risk management framework should be able to assess the risk of the loan and price it accurately
 - potential reduction in volume of defaulting loans as platforms should be able to understand the risk of loans which should make expected defaults estimates closer to actual defaults figures
 - investors are better able to understand investment risk, make informed investment decisions and be appropriately remunerated for the risk they are taking
- 75.** For platforms that are complying with the relevant existing rules and guidance in PRIN, SYSC and CONC, these benefits may already be largely realised.
- 76. Governance:** Robust governance arrangements that are in line with the complexity of a platform's business reinforce acceptable standards of conduct, deter misconduct, avoid conflicts of interests and ultimately drive appropriate platform cultures. Better platform cultures improve outcomes for consumers by reducing behaviour that advances the interest of the platform to the detriment of its investors.
- 77.** For platforms that are complying with the relevant existing rules and guidance in PRIN, SYSC, these benefits may already be realised.
- 78. Wind-down arrangements:** Investors will be more likely to have their loans continue to be managed and administered during a wind-down period, if at any time the platform ceases to manage and administer the P2P agreements itself.
- 79.** For platforms that are complying with the relevant existing rules and guidance in SYSC, these benefits may already be largely realised.
- 80. Marketing Restrictions:** Individual investors who are impacted by the 10% restriction are likely to end up with a more diversified investment portfolio as a result. The benefits of this are that diversified investors face a smaller risk of losing a large part of their invested wealth. However, it should be acknowledged that some investors impacted by the 10% restriction could conceivably respond by concentrating their investment in another single instrument resulting in a less diversified portfolio.
- 81. Disclosure:** The disclosure rules proposed in this CP will reduce information asymmetries and the associated risk of investors not understanding the nature and type of risk they will be exposed to. Improved disclosure will allow investors to be able to assess more accurately such risks. Enabling them to make better investment decisions, reducing potential consumer detriment and drive more effective competition in the market.
- 82.** For platforms that are complying with the relevant existing rules and guidance in COBs these benefits may already be largely realised.



Indirect impacts

- 83.** Increased compliance costs will increase platforms' operating costs. This could have indirect effects on the market, such as increased barriers to entry and, possibly, as a result, discourage innovation, reducing choice for consumers. However, we consider that these additional costs are likely to be manageable for platforms as overall costs per platform are small. We do not expect the overall impact on innovation in the crowdfunding market to be material or these proposals to act as a significant barrier to entry.
- 84.** The proposals should raise standards and help reduce information asymmetry. It is possible that clearer disclosure of investment risks may have an impact on investor demand and innovation, possibly even leading platforms to simplify their more complex propositions. We do not consider that this should necessarily be regarded as a cost. Rather, we consider that some of the innovation and complexity in this market, which is not always apparent to investors, may not be in line with the level of risk an investor understood they were taking when making their investment decision. We consider that investors are likely to behave in more rational ways if they have a clearer understanding of the nature and risks of the investment.
- 85.** Also, more accurate credit assessment undertaken by P2P platforms may have the effect of changing costs to some borrowers. We do not see this as a cost, as the cost reflects a more accurate (and therefore fair) assessment of the credit risk of a borrower.

Costs to the FCA

- 86.** We do not consider that our proposed approach will result in any increase in costs for the FCA. The proposed changes will not result in any systems changes, and we can subsume the limited number of additional approved persons applications that may arise within our existing supervisory activity.
- 87.** The rest of the proposals discussed in this CP are not expected to generate material incremental costs to the FCA.

Q33: Do you have any comments on our cost benefit analysis for the proposals arising from the post-implementation review?

P2P platforms: mortgages and other home finance

- 88.** We are also proposing to extend our rules for home finance providers to platforms which facilitate home finance products where at least one of the investors is not an authorised home finance provider. We call these home finance platforms in the rest of this annex.

Market Failure Analysis

89. We have identified a number of potential harms which could impact home finance customers if they were to transact via a home finance platform. In particular, we are concerned that customers might:

- make poor purchasing decisions and buy unsuitable products
- buy unaffordable products, resulting in a risk of falling into arrears or having their home repossessed
- be treated unfairly in case of payment shortfalls

90. These potential harms are particularly relevant to the FCA's operational objectives of consumer protection.

91. In this section we analyse the economic drivers of such harms.

Information Asymmetries

92. Customers are likely to know significantly less than the home finance platform about key features of products and services provided:

- customers might make poor purchasing decisions because they do not have access to information about the key features of the proposed products and services, and of the effects of particular events
- home finance platforms might be in a position to exploit these information asymmetries to profit from fees levied on late payments and additional charges when a customer goes into arrears

Misaligned incentives

93. Unrecognised conflicts of interest between the home finance platform and home finance customers lead to misaligned incentives:

- home finance platforms might not have strong incentives to use adequate criteria to assess affordability because they could over-rely on investors bearing the cost of default
- home finance platforms might not have incentives to compete on how fairly they treat customers in payment difficulties
- home finance platforms might not offer the most appropriate forbearance options because there is a conflict of interest between the investor(s) and home finance customer

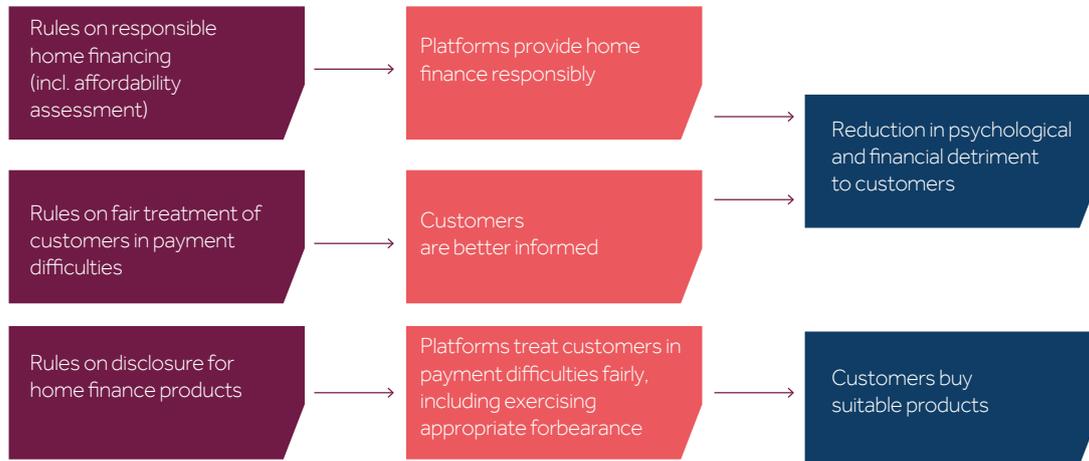
Behavioural biases

94. Over-optimism bias can prevent customers from choosing the best course of action:

- customers might purchase unaffordable products because they focus only on the short-term cost of the product and are unclear about long-term affordability
- customers might also make poor purchasing decisions because they have difficulty in understanding the information made available to them on costs they are paying, charges they may receive, and product risks

Cost benefit analysis

Causal Chain 2



Key Facts and assumptions

95. We are not aware of any P2P platforms currently facilitating home finance products, or any which are imminently planning on doing so. However, our proposals will result in costs, both one-off and ongoing, for any P2P platforms that wish to do so in the future. We analyse the costs and benefits of the proposals compared to the current situation, where a home finance platform would not be required to fulfil the regulatory obligations of the home finance provider.
96. Based on our understanding of the P2P market, it seems most likely that a P2P platform moving into the home finance sector will already have been operating in the P2P unsecured credit market. They would therefore be subject to CONC/Consumer Credit Act 1974 (CCA) rules. As set out in Chapter 5, they may also be subject to certain CONC rules on creditworthiness and treatment of customers in arrears (among others) as a result of facilitating certain home finance products. This is relevant when considering the incremental costs incurred by home finance platforms as a result of our proposals.
97. As set out in Chapter 7, a home finance platform is also likely to be performing a regulated arranging activity. It would therefore be subject to our MCOB rules for arrangers, whether or not we make the new rules proposed here. We have therefore not analysed the costs and benefits of these rules except where we have proposed modifications to them.
98. As no P2P home finance market currently exists it is not possible to survey firms about the potential cost impact of our proposals. To provide estimates of the costs and benefits of our proposals, we have considered CBA data from other relevant consultations, where firms which were already subject to one set of regulatory rules moved into our home finance regime. We have used these data to estimate the likely costs and benefits of our proposals.
99. Where we give figures taken from prior CBA work, these have been adjusted for inflation and reported below in current prices.¹⁹ There may be additional costs we have not been able to identify. Actual costs may also be lower than our estimates because

19 Using Retail Price Index. <https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/chaw/mm23>

these estimates are based on surveying traditional home finance firms. For example, P2P platforms might have more efficient technology than mainstream lenders. We would welcome feedback on our CBA approach and conclusions from consultation respondents.

Costs

Responsible lending and financing

100. We propose that the responsible lending and financing rules in MCOB 11 apply to home finance platforms. MCOB 11 includes the requirement to undertake an affordability assessment prior to entering into a home finance product. We assume for the purposes of this analysis that a home finance platform in this position would not have systems or procedure in place to assess affordability in line with MCOB 11, though they may have means of otherwise checking creditworthiness. For example, if they are already performing the regulated platform activity²⁰ they will be required to perform creditworthiness assessments consistent with the rules in CONC, including for any mortgages or home purchase plans they facilitate.

101. In the CBA of our proposals for second charge lending, it was estimated that the cost of compliance with MCOB 11 for second-charge mortgage firms would be £103,400 in one-off costs and £25,900 in ongoing costs per firm.²¹ We estimate that the costs of implementation for home finance platforms will be broadly in line with this but would vary according to how they meet the CONC creditworthiness assessment rules and how similar that may be to the rules of MCOB 11. This estimate also excludes the cost of acquiring a new assessment system,²² on the basis that home finance platforms are likely to have some system in place due to the creditworthiness assessment rule.

Treatment of customers with a payment shortfall

102. Under our proposed rules home finance platforms will have to comply with our MCOB 13 rules on the fair treatment of customers in arrears. Home finance platforms will incur costs associated with activities such as recording phone calls and making efforts to obtain the best price of a property upon repossession. These are in addition to other MCOB 13 rules which are in line with, or less stringent than, the CONC rules which we propose to disapply. We anticipate that home finance platforms would incur one-off costs similar to second-charge firms of approximately £38,900 and ongoing costs of £55,600.²³

Disclosure

103. We are making a number of amendments to our disclosure rules for home finance platforms. First, we are applying our MCOB 6 rules to require home finance platforms to give a disclosure to the customer at the contract offer stage. When this rule was introduced for mortgage lenders, we estimated the yearly cost of offer stage disclosure. This amounted to £45,500 per year per firm, largely comprising additional sales and processing time and document printing costs.²⁴ We expect that the costs for home finance platforms would not exceed this figure, and would more than likely be less as the disclosure may not be given on paper. We consider that these costs will be

20 The regulated activity of 'operating an electronic system in relation to lending'. This is set out in article 36H of the Regulated Activities Order.

21 Cost benefit analysis and policy proposals for second charge lending (September 2014): www.fca.org.uk/publication/research/cba-second-charge-lending.pdf. The CBA used data from a variety of firms including ones who were already subject to MCOB for other regulated home finance activity. This reflects the scenario for platforms, which will likely be subject to some MCOB requirements by virtue of being home finance arrangers.

22 Cost estimated by one large lender at the current price between £270,000-540,000.

23 Cost benefit analysis and policy proposals for second charge lending (September 2014): www.fca.org.uk/publication/research/cba-second-charge-lending.pdf

24 CP 186 Mortgage regulation: Draft conduct of business rules and feedback on CP146 (May 2003): www.fsa.gov.uk/pubs/cp/cp186_vol1.pdf



similar for home finance platforms facilitating equity release transactions, which will be subject to the tailored product disclosure rules at MCOB 9 as a result of our proposals.

- 104.** We are also proposing to require home finance platforms to give a disclosure document to the customer at the start of the contract, as per MCOB 7.4 (or MCOB 7.8 for home purchase plans). When this rule was introduced for mortgage lenders we stated that, as the information required was already given to the customer by the vast majority of firms, there would be no increase in costs or the increase would be of minimal significance. We would likewise expect a home finance platform to provide the information required at the start of the contract as a matter of course. This is because it contains basic information such as the amount of payments required and the method by which payment will be collected. Therefore, we also consider that this requirement will not lead to costs for home finance platforms, or that those costs will be of minimal significance.
- 105.** In addition, we propose that home finance platforms should provide customers with an annual statement in line with MCOB 7.5 & MCOB 7.8. When we introduced these rules, we estimated the cost at £48,600 per firm.²⁵ As with other forms of disclosure we consider that the costs for home finance platforms would be less given the web-based nature of the proposition, with potential savings on printing costs.
- 106.** The final component of MCOB 7.6 is the requirement to provide event-driven information. We estimated that this would cost approximately 64p per home finance customer²⁶ when we introduced it and again we would expect the cost for home finance platforms to be in line with or less than this.²⁷
- 107.** Finally, we are proposing that home finance platforms make certain modifications to their pre-sale disclosure documents to make them more suitable to the P2P platform business model. The average cost to second-charge mortgage firms to start issuing a European Standardised Information Sheet (ESIS) was £29,400.²⁸ However, we expect that the costs of amending the disclosure document would be significantly less. We are proposing minor amendments to our initial disclosure rules at MCOB 4.4A. These will remove certain rules for home finance platforms which are irrelevant and allow for tailored disclosures in certain places. Home finance platforms will not bear the cost of this, or, if they do, any costs will be minimal. Home finance platforms will simply have to adjust the information provided in the initial disclosure to adopt these incremental changes prior to entering into the market.

Other MCOB standards

- 108.** As a result of our proposals, home finance platforms will be subject for the first time to our MCOB rules on fees and charges, including MCOB 12 restrictions on early repayment charges (ERCs), arrears charges, and a general prohibition on excessive charges. Calculating the cost of these proposals for home finance platforms is challenging given that it requires estimating a hypothetical loss of revenue due to the restrictions. We asked second charge firms in 2014 about the likely impact of the

25 Figure calculated assuming that the firm population size used was 220: 120 larger mortgage lenders and 100 small and medium sized lenders. CP 98 The Draft Mortgage Sourcebook, including Policy Statement on CP70 (June 2001): www.fsa.gov.uk/pubs/cp/cp98.pdf

26 We have not estimated per firm costs. We do not think it is reasonably practicable to estimate the number of home finance customers each platform would be likely to have as there are not currently any platforms active in the market.

27 CP 98 The Draft Mortgage Sourcebook, including Policy Statement on CP70 (June 2001): www.fsa.gov.uk/pubs/cp/cp98.pdf

28 Cost benefit analysis and policy proposals for second charge lending (September 2014): www.fca.org.uk/publication/research/cba-second-charge-lending.pdf

MCOB 12.3 rules on the calculation of ERCs. In the survey many felt that no cost would be incurred as they generally charged less than what is permissible under the rules.²⁹

- 109.** On arrears charges, many lenders also felt that they had systems in place to ensure charges reflect costs, but gave average one-off costs of £3,000 and ongoing costs of £2,200 per year.³⁰ The cost to home finance platforms is likely to be lower as they may already be subject to arrears charges rules in CONC 7.7.5. MCOB 12.5 prohibiting excessive charges is also unlikely to lead to significant costs as it is a high-level requirement in line with the requirement under Principle 6 to treat customers fairly. Ultimately, cost will only be incurred by home finance platforms if they were planning to operate charging structures which would be inconsistent with MCOB 12, and we have no evidence that this is likely to be the case. We therefore consider that this measure will not result in costs to home finance platforms, or any increase in costs will be minimal.
- 110.** Under our proposals home finance platforms will, where relevant, need to consider MCOB 10, which provides the formula for calculating an APR and total charge for credit to be used in disclosure documents and advertisements. The MCOB rules are similar to those for consumer credit, so P2P platforms facilitating regulated credit agreements will be familiar with them. We consider that this measure will not result in costs to firms, or any increase in costs will be of minimal significance.
- 111.** As outlined above, the majority of our MCOB 2 conduct of business rules will already apply to home finance platforms. MCOB 2.6A currently only applies to home finance providers, and we are proposing to extend this to home finance platforms. However, this is an extension of Principle 6 and the requirement to treat customers fairly. Therefore, we do not consider it will result in costs to home finance platforms, or any increase in costs will be of minimal significance.

Data reporting

- 112.** Finally, we are proposing to introduce our sales data (PSD) and aggregated returns data (MLAR) reporting rules for home finance platforms. We anticipate that this will result in both one-off and ongoing costs. In the CBA of our proposals for second-charge lending, it was found that the average one-off costs for second-charge firms would be £62,700, and the average ongoing costs would be £43,700 per year.³¹ Home finance platforms are likely to incur similar costs as second-charge firms, as both populations were not subject to data reporting rules prior to our rule changes.

Benefits

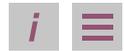
- 113.** We consider that the extension of our mortgage rules to home finance platforms will lead to benefits and lower costs for customers of home finance platforms. These are the same as other benefits we have highlighted in previous consultation papers, where the baseline was also protections arising from some lender rules.³²
- 114.** The benefits of our proposals include the following:
- Ensuring home finance platforms carry out affordability assessments will help ensure that customers do not take out agreements they cannot afford, reducing

29 Cost benefit analysis and policy proposals for second charge lending (September 2014): www.fca.org.uk/publication/research/cba-second-charge-lending.pdf

30 Cost benefit analysis and policy proposals for second charge lending (September 2014): www.fca.org.uk/publication/research/cba-second-charge-lending.pdf

31 Cost benefit analysis and policy proposals for second charge lending (September 2014): www.fca.org.uk/publication/research/cba-second-charge-lending.pdf

32 CP 14/20, FSA CP 10/02, FSA CP 146, FSA CP 98



the risk of payment problems, arrears charges, and potential repossession of their home. In CP14/20 we also noted that payment problems can lead to stress and effects on well-being and mental health.³³ This proposal helps prevent such harms. Affordability checks will also reduce investors' exposure to unsustainable, high risk activity and thus support market integrity. In the absence of an existing market, the extent to which these checks will curtail potential activity, or how many consumers may be affected, cannot be reasonably estimated.

- Ensuring strong consumer protections for customers in arrears and at risk of repossession may have additional benefits for customers. For example, the protections may help customers deal with payment difficulty in a way that is tailored to their individual needs and circumstances. Customers may also be less likely to incur arrears charges. This is because MCOB 13 requires firms to make reasonable efforts to reach an agreement with a customer over the method of repaying any payment shortfall. MCOB 13 also requires firms to allow a reasonable time over which the payment shortfall should be repaid.
- Adequate disclosures of post-contractual information as a result of our MCOB 7 rules (or MCOB 9 for equity release) should result in customers better understanding their products and the effect of particular events. For example, they might understand changes to the payments required resulting from interest rate changes. Such disclosures will allow them to better manage their contract.
- Data reporting rules should help support the realisation of benefits offered by our home finance regime. They ensure we are able to effectively monitor firms' behaviour and market outcomes, therefore increasing the likelihood of compliance.

115. We do not consider that our proposed approach will result in any increase in costs for the FCA. The proposed changes will not result in any systems changes, and we can subsume the transactions in question within our existing supervisory activity.

116. We have also considered the impact of the proposals on competition. Our proposals in relation to home finance platforms introduce a level playing field for all platforms seeking to facilitate home finance products, irrespective of their exact business models. This should ensure minimum standards of protection across the market.

117. It is possible that that the estimated cost of compliance with these changes could stop certain P2P platforms from entering the home finance market. This could impact the development of a P2P home finance market, potentially discouraging innovation and reducing consumer choice.

118. We consider that these potential impacts are outweighed by the benefits of ensuring that customers of home finance platforms enjoy the same level of protection as other home finance customers. We also consider that, by increasing customer confidence, the proposals would support the growth of this market in the future, as we have seen in other P2P markets.

Q34: Do you have any comments on our cost benefit analysis for the P2P mortgage and home finance proposals?

33 CP 14/20 Implementation of the Mortgage Credit Directive and the new regime for second charge mortgages (September 2014): www.fca.org.uk/publication/consultation/cp14-20.pdf

Annex 3

Compatibility statement

Compliance with legal requirements

1. This annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).
2. When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules is (a) compatible with its general duty, under s.1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, and (b) its general duty under s.1B(5)(a) FSMA to have regard to the regulatory principles in s.3B FSMA. The FCA is also required by s.138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.
3. This annex also sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (s.1B(4)). This duty applies insofar as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.
4. In addition, this annex explains how we have considered the recommendations made by the Treasury under s.1JA FSMA about aspects of the economic policy of Her Majesty's Government to which we should have regard in connection with our general duties.
5. This annex includes our assessment of the equality and diversity implications of these proposals.
6. Under the Legislative and Regulatory Reform Act 2006 (LRRRA) the FCA is subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This annex sets out how we have complied with requirements under the LRRRA.



The FCA's objectives and regulatory principles: Compatibility statement

7. Our proposals contribute to the FCA's operational objective of consumer protection.
8. We have considered what is the appropriate degree of protection for consumers in light of the matters set out in section 1C FSMA:

Differing degrees of risk involved in different kinds of investment or other transactions

9. Where appropriate, our proposals differentiate between the activities observed within various business models operating in the sector. The purpose behind this is to be proportionate to the different risks that the different business models pose. Therefore, the more complex the business model is, the more requirements the platform will have to comply with to make sure the risks are managed appropriately.

Differing degrees of experience and expertise that different consumers have

10. Our proposals regarding marketing restrictions aim at differentiating consumers so that those who are not high net worth individuals or have not had exposure to this sector in the recent past, can only receive direct offer financial promotions if they certify that they have not invested more than 10% of their net investible assets in P2P agreements. This protection is intended to protect the less experienced consumer from being overly-exposed to this asset class.
11. The disclosure requirements proposed are intended to allow investors to have sufficient information to be able to make an informed decision.

The needs that consumers may have for the timely provision of information and advice that is accurate and fit for purpose

12. The purpose behind some of the disclosure requirements, like the requirement for publication of default rates on a quarterly basis, is that investors are aware on a timely basis of the status of the platforms' loan book so that they can make relevant investment decisions. Our proposals in Chapter 7 to extend MCOB disclosure requirements to platforms when they facilitate home finance transactions will ensure that P2P home finance customers receive the same information that they would receive if the provider was authorised.

The general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question

13. The package of proposals in this CP aim to enable P2P platforms to structure their businesses so that incentives are aligned with the principles of treating customers fairly and conducting business with skill, care and due diligence. They also aim to give investors and home finance customers sufficient information to understand the nature and risk of an investment or home finance product before making a decision.

The differing expectations that consumers may have in relation to different kinds of investment or other transaction

14. Our proposals take into account the different business models operating within the sector, which have the potential to create different expectations from the perspective of the investor, not least because of how the investment outcomes are marketed. For example, in complex models that advertise a target rate of return or offer a secondary market, we identified the risk that some consumers may believe that their investment

is liquid, much like a deposit account, or may not understand that they may lose money by exiting the original arrangement, or receive less than if they had held the loan until maturity. Also, investors may not understand what would happen to their investment in practice if the platform were to cease operating for any reason. The proposals in this CP for improved disclosures and improved wind-down arrangements aim to ensure that investors understand the nature and risk of investing in a P2P agreement.

15. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s.3B FSMA. In particular:

The need to use our resources in the most efficient and economic way

16. We consider that the proposals set out in this CP are consistent with an efficient and economic use of our resources. They provide a clearer view of what are expectations are in relation to the P2P sector, and following implementation we do not expect any significant change in the level of resources the FCA uses, relative to the costs of regulating the current regime.

The principle that a burden or restriction should be proportionate to the benefits

17. We consider that our proposals will have a positive impact on ensuring that the burdens and restrictions placed on platforms are proportionate to the benefits. We have undertaken a cost-benefit analysis of our proposals, which is included in Annex 2 of this CP.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

18. We consider that our proposals support access to capital for UK SMEs and promote sustainable growth in the crowdfunding and P2P market.

The general principle that consumers should take responsibility for their decisions

19. The proposed rules enable consumers to take responsibility for their investment decisions. While we aim to reduce both the probability and impact of failure of P2P platforms in the future, our proposed rules focus on ensuring that platforms disclose adequate information to allow investors to make informed investment decisions. Our proposals in respect of home finance platforms aim to provide sufficient information to consumers to enable them to take responsibility for their actions and decisions.

The responsibilities of senior management

20. This CP includes proposals to ensure P2P platforms have adequate systems and controls in place in line with their offerings, and that those systems and controls are overseen by appropriate governance.

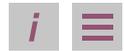
The desirability of publishing information relating to persons subject to requirements imposed under FSMA, or requiring them to publish information

21. We have had regard to this principle and we do not consider that our proposals will impact on this.

The principle that we should exercise our functions as transparently as possible

22. We will continue to engage with stakeholders throughout this consultation process prior to making any rules.

23. In formulating these proposals, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention



of the general prohibition, to be used for a purpose connected with financial crime (as required by s. 1B(5)(b) FSMA).

Expected effect on mutual societies

24. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies.
25. Currently there are no mutual societies involved in the provision of regulated crowdfunding or P2P activities so there should be no direct impact. If a mutual society were to enter the sector, it would be expected to comply with our rules in the same way as other regulated crowdfunding and P2P platforms.

Compatibility with the duty to promote effective competition in the interests of consumers

26. In preparing the proposals as set out in this consultation, we have had regard to the FCA's duty to promote effective competition in the interests of consumers.
27. Competition is enhanced if firms operate on the basis of a level playing field and have a common understanding of the regulatory regime and regulatory expectations. Otherwise some firms may gain an advantage by undertaking less rigorous credit risk analysis.
28. Our proposed rules aim to create an environment where platforms can compete for business on equal terms. The standardised definition of default is an example of this. By proposing that all platforms use the same definition of default we make it easier for potential investors to compare different platforms and therefore promote effective competition. Our home finance proposals also create a level playing field between conventional lenders and platforms who offer home finance.
29. Similarly, our proposed disclosure requirements aim to allow investors to be able to compare like with like when it comes to P2P platforms' disclosures. This will help investors make a more informed decision about both platforms they wish to use and the investment(s) facilitated by them.

Equality and diversity

30. We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, to and foster good relations between people who share a protected characteristic and those who do not.

31. As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. The outcome of our consideration in relation to these matters in this case is stated in Chapter 1.

Legislative and Regulatory Reform Act 2006 (LRR)

32. We have had regard to the principles in the LRR for the parts of the proposals that consist of general policies, principles or guidance and consider that they are proportionate and result in an appropriate level of consumer protection, without creating undue burdens of platforms or an adverse impact on competition. For example, are proposals take into account the different business models operating within the sector, and aim to strengthen and clarify the existing requirements, to improve investor protection and provide certainty about what we expect from platforms.
33. We have had regard to the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance and consider that the proposals are proportionate to the potential market failures identified.

Treasury recommendations about economic policy

34. We have had regard to the Treasury's recommendations under s. 1JA FSMA.
35. Treasury's recommendations most relevant to our proposals are the following:
- The government's economic policy - 'continuing to strengthen the financial system, improving the regulatory framework to reduce risks to the taxpayer and building resilience, so that it can provide finance and financial services to the real economy and realise better outcomes for consumers, supporting sustainable economic growth and encouraging productive investment.'
 - Matters about aspects of the government's economic policy that relate to 'Growth' and 'Better outcome for consumers'.
36. Our proposals build on existing high level requirements by providing more detailed systems and controls rules for the P2P sector. The intention is to be clear about the standards that will apply to these platforms, and to address the unique characteristics of the sector. In addition, they aim to improve outcomes for consumers by improving transparency of investment risk and aligning consumers' remuneration with the risks they are taking.
37. Therefore, they intend to have a positive impact on the financial systems by improving the regulatory framework to reduce risks and realise better outcomes for consumers, while encouraging sustainable growth.



Annex 4

Abbreviations used in this paper

AIFMD	Alternative Investment Fund Managers Directive
APR	Annual percentage rate
APRC	Annual percentage rate of charge
CASS	Client Assets sourcebook
CBA	Cost benefit analysis
CCA	Consumer credit agreement
COBS	Conduct of Business sourcebook
CONC	Consumer Credit sourcebook
CP	Consultation paper
ESIS	European Standardised Information Sheet
FCA	Financial Conduct Authority
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
IT	Information technology
KFI	Key Facts Illustration
MCD	Mortgage Credit Directive
MCOB	Mortgage and Home Finance: Conduct of Business sourcebook
MiFID	Markets in Financial Instruments Directive
MLAR	Mortgage Lenders and Administrators Return
NMPI	Non-mainstream pooled investments
NRRS	Non-readily realisable securities
OFT	Office of Fair Trading

P2P	Peer to Peer
PIR	Post-implementation review
PSD	Product Sales Data
SM&CR	Senior Managers & Certification Regime
SMEs	Small and medium-sized enterprises
SPV	Special purpose vehicle
SUP	Supervision manual
SYSC	Senior Manager Arrangements, Systems and Controls sourcebook
UK	United Kingdom

We have developed the policy in this Consultation Paper in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 9644 or email: publications_graphics@fca.org.uk or write to: Editorial and Digital team, Financial Conduct Authority, 12 Endeavour Square London E20 1JN



Appendix 1

Draft Handbook text

OPERATING AN ELECTRONIC SYSTEM IN RELATION TO LENDING (PEER-TO-PEER LENDING) INSTRUMENT 2018

Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (General rule-making power);
 - (2) section 137R (Financial promotion);
 - (3) section 137T (General supplementary powers); and
 - (4) section 139A (Power of the FCA to give guidance).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on [*six months after the date the instrument is made*].

Amendments to the Handbook

- D. The modules of the Financial Conduct Authority’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Senior Management Arrangements, Systems and Controls sourcebook (SYSC)	Annex B
Conduct of Business sourcebook (COBS)	Annex C

Citation

- E. This instrument may be cited as the Operating an Electronic System in Relation to Lending (Peer-to-Peer Lending) Instrument 2018.

By order of the Board
[*date*]

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise indicated.

Insert the following new definitions in the appropriate position. The text is not underlined.

<i>credit risk assessment</i>	the assessment required by <i>COBS</i> 18.12.5R.
<i>contingency fund</i>	(in relation to an <i>operator of an electronic system in relation to lending</i>) a fund, trust, <i>body corporate</i> , segregated account or any other arrangement whose activities include making payments to a lender when a borrower does not meet its obligations under a <i>P2P agreement</i> .
<i>contingency fund policy</i>	the policy required by <i>COBS</i> 18.12.34R.
<i>outcomes statement</i>	the statement required by <i>COBS</i> 18.12.19R.
<i>P2P portfolio</i>	a collection of agreements that wholly consists of <i>P2P agreements</i> or a combination of <i>P2P agreements</i> and <i>non-P2P agreements</i> facilitated by an <i>operator of an electronic system in relation to lending</i> for a lender with the aim of achieving a <i>target rate</i> .
<i>P2P resolution manual</i>	the manual required by <i>SYSC</i> 4.1.8DBR.
<i>risk management framework</i>	the framework required by <i>COBS</i> 18.12.16R.
<i>target rate</i>	the overall rate of return, however expressed, that an <i>operator of an electronic system in relation to lending</i> offers, in whatever manner, to achieve for a lender using a <i>P2P portfolio</i> .

Amend the following definitions as shown.

<i>default</i>	<ol style="list-style-type: none"> (1) (in relation to the <i>IRB approach</i> and for the purposes of <i>BIPRU</i>) has the meaning in <i>BIPRU</i> 4.3 (The <i>IRB approach</i>: Provisions common to different exposure classes). (2) (in <i>MIPRU</i>) for any credit obligation a borrower has with a <i>firm</i>, an event where: <ol style="list-style-type: none"> (a) the borrower is past the contractual payment due date by more than 90 days; and
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- (b) the *firm* reasonably considers that the borrower is unlikely to pay or otherwise fulfil its credit obligations to the *firm*.

(3) (in relation to an operator of an electronic system in relation to lending) an event where:

- (a) in respect of a P2P agreement that is not secured on property, the borrower is past the contractual payment due date by more than 90 days; or
- (b) in respect of a P2P agreement that is secured on property, the borrower is past the contractual payment due date by more than 180 days.

management body

(1) (other than in (2) or (3)) (in accordance with article 3(7) of *CRD* and article 4.1(36) of *MiFID*) the *governing body* and *senior personnel* who are empowered to set the *person's* strategy, objectives and overall direction, and which oversee and monitor management decision-making in the following:

- (a) a *common platform firm* (in relation to the requirements imposed by or under *MiFID* or *MiFIR*); or
- (b) a *recognised investment exchange*; or
- (c) a *data reporting services provider*.

(2) (in *COLL* and in *SYSC* 19E and in accordance with article 2(1)(s) of the *UCITS Directive*), the *governing body* of a *management company* or *depository* of a *UCITS scheme* or an *EEA UCITS scheme*, as applicable, with ultimate decision-making authority comprising the supervisory and the managerial function or only the managerial function, if the two functions are separated.

(3) (in relation to an operator of an electronic system in relation to lending) the governing body with ultimate decision-making authority comprising the supervisory and the managerial function or only the managerial function, if the two functions are separated.

price

(1) (in *COLL*) (in relation to a *unit* in an *authorised fund*) the price of the *unit* calculated in accordance with *COLL* 6.3 (Valuation and pricing).

(2) (in *COBS*) (in relation to an operator of an electronic system in relation to lending):

- (a) at origination of a loan in relation to which a P2P agreement is made, the interest rate to be paid by the borrower to the lender in respect of that P2P agreement;
- (b) in relation to any transaction after the origination of a loan in relation to which a P2P agreement is made, the amount to be paid (or, where the context requires, that was paid), for the present value of the principal and the interest rate to be paid by the borrower, in respect of that P2P agreement.

supervisory function

- (1) any function within a *common platform firm* that is responsible for the supervision of its *senior personnel*.
- (2) (in relation to a *management company* and in accordance with article 3(6) of the *UCITS implementing Directive*) the *relevant persons* or body or bodies responsible for the supervision of its *senior personnel* and for the assessment and periodic review of the adequacy and effectiveness of the risk management process and of the policies, arrangements and procedures put in place to comply with its obligations under the *UCITS Directive*.
- (3) (in relation to an operator of an electronic system in relation to lending) any function within the firm that is responsible for the supervision of its senior personnel.

Annex B

Amendments to the Senior Management, Systems and Controls sourcebook (SYSC)

In this Annex, underlining indicates new text and striking through indicates deleted text.

1 Annex 1 Detailed application of SYSC

...

Table A: Application of the common platform requirements in SYSC 4 to SYSC 10

Provision	COLUMN A	COLUMN A+	COLUMN A++	COLUMN B
SYSC 4	Application to a common platform firm other than to a UCITS investment firm	Application to a UCITS management company	Application to a full-scope UK AIFM of an authorised AIF	Application to all other firms apart from insurers, UK ISPVs, managing agents, the Society, full-scope UK AIFMs of unauthorised AIFs, MiFID optional exemption firms, and third country firms
...
SYSC 4.1.8G	...	...	...	...
<u>SYSC 4.1.8AR</u>	<u>Applies as a rule only to an operator of an electronic system in relation to lending.</u>	<u>Not applicable</u>	<u>Not applicable</u>	<u>Applies as a rule only to an operator of an electronic system in relation to lending.</u>
<u>SYSC 4.1.8CG</u>	<u>Applies as guidance only to an operator of an electronic system in relation to lending.</u>	<u>Not applicable</u>	<u>Not applicable</u>	<u>Applies as guidance only to an operator of an electronic system in relation to lending.</u>

<u>SYSC 4.1.8DG</u>	<u>Applies as guidance only to an operator of an electronic system in relation to lending.</u>	<u>Not applicable</u>	<u>Not applicable</u>	<u>Applies as guidance only to an operator of an electronic system in relation to lending.</u>
<u>SYSC 4.1.8DAG</u>	<u>Applies as guidance only to an operator of an electronic system in relation to lending.</u>	<u>Not applicable</u>	<u>Not applicable</u>	<u>Applies as guidance only to an operator of an electronic system in relation to lending.</u>
<u>SYSC 4.1.8DBR</u>	<u>Applies as a rule only to an operator of an electronic system in relation to lending.</u>	<u>Not applicable</u>	<u>Not applicable</u>	<u>Applies as a rule only to an operator of an electronic system in relation to lending.</u>
<u>SYSC 4.1.8DCR</u>	<u>Applies as a rule only to an operator of an electronic system in relation to lending.</u>	<u>Not applicable</u>	<u>Not applicable</u>	<u>Applies as a rule only to an operator of an electronic system in relation to lending.</u>
<u>SYSC 4.1.8DDR</u>	<u>Applies as a rule only to an operator of an electronic system in relation to lending.</u>	<u>Not applicable</u>	<u>Not applicable</u>	<u>Applies as a rule only to an operator of an electronic system in relation to lending.</u>
...
<u>SYSC 4.3.1R</u>	...	...	...	...
<u>SYSC 4.3.2R</u>	Not applicable	Rule	Not applicable	Guidance - (but; (a) <u>applies as a rule to an operator of an electronic system in relation to lending; and (b)</u>

				not applicable to <i>incoming EEA firms, incoming Treaty firms or UCITS qualifiers</i>)
SYSC 4.3.2AG	Not applicable	Not applicable	Not applicable	Guidance (but not applicable to <i>incoming EEA firms, incoming Treaty firms</i> or <i>UCITS qualifiers</i> , <u>or an operator of an electronic system in relation to lending</u>)
...

...

Provision	COLUMN A	COLUMN A+	COLUMN A++	COLUMN B
SYSC 6	Application to a common platform firm other than to a UCITS investment firm	Application to a UCITS management company	Application to a full-scope UK AIFM of an authorised AIF	Application to all other firms apart from insurers, UK ISPVs, managing agents, the Society, full-scope UK AIFMs of unauthorised AIFs, MiFID optional exemption firms, and third country firms
...
SYSC 6.1.1AG	...	...	...	...
SYSC 6.1.2R	Not applicable	Rule	Not applicable	Guidance, <u>but applies as a rule to an operator of an electronic system in relation to lending</u>

SYSC 6.1.2AG	Not applicable	Not applicable	Not applicable	Guidance, <u>but does not apply to an operator of an electronic system in relation to lending</u>
SYSC 6.1.3R	Not applicable	Rule	Not applicable	<p>Guidance, <u>but applies as a rule to an operator of an electronic system in relation to lending</u></p> <p><u>For firms other than an operator of an electronic system in relation to lending, this</u> This provision shall be read with the following additional sentence at the start. “Depending on the nature, scale and complexity of its business, it may be appropriate for a <i>firm</i> to have a separate compliance function. Where a <i>firm</i> has a separate compliance function, the <i>firm</i> should also take into account SYSC 6.1.3R and SYSC 6.1.4R as guidance.”</p>
SYSC 6.1.3AG	Not applicable	Not applicable	Not applicable	- Guidance, <u>but does not apply to an operator of an electronic system in relation to lending</u>

SYSC 6.1.4R	Not applicable	Rule	Not applicable	(1), (3) and (4): Guidance; (2): - Rule for <i>firms</i> which carry on <i>designated investment business</i> with or for <i>retail clients</i> or <i>professional clients</i> . - Guidance for all other <i>firms</i> . <u>Applies as a rule to an operator of an electronic system in relation to lending.</u>
SYSC 6.1.4-AG	...	...	...	...
...
SYSC 6.1.5R	Not applicable	Rule	Not applicable	- Guidance, <u>but applies as a rule to an operator of an electronic system in relation to lending</u> - “investment services and activities” shall be read as “financial services and activities”
SYSC 6.1.6G	Not applicable	Not applicable	Not applicable	Guidance, <u>but does not apply to an operator of an electronic system in relation to lending</u>
SYSC 6.1.7R	...	...	...	...

SYSC 6.2.1R	Not applicable	Rule	Not applicable	Guidance, <u>but applies as a rule to an operator of an electronic system in relation to lending</u>
SYSC 6.2.1AG	Not applicable	Not applicable	Not applicable	Guidance, <u>but does not apply to an operator of an electronic system in relation to lending</u>
...

Provision	COLUMN A	COLUMN A+	COLUMN A++	COLUMN B
SYSC 7	Application to a common platform firm other than to a UCITS investment firm	Application to a UCITS management company	Application to a full-scope UK AIFM of an authorised AIF	Application to all other firms apart from insurers, UK ISPVs, managing agents, the Society, full-scope UK AIFMs of unauthorised AIFs, MiFID optional exemption firms, and third country firms
...
SYSC 7.1.1G	...	...	...	...
SYSC 7.1.2R	Not applicable	Rule for a <i>UCITS investment firm</i> in relation to its non-MiFID business; otherwise guidance	Not applicable	Guidance, <u>but applies as a rule to an operator of an electronic system in relation to lending</u>
SYSC 7.1.2AG	Not applicable	Not applicable to a <i>UCITS investment</i>	Not applicable	Guidance, <u>but does not apply to an operator of an</u>

		<i>firm</i> ; otherwise guidance		<u><i>electronic system in relation to lending</i></u>
SYSC 7.1.2BG	...	...	...	...
SYSC 7.1.3R	Not applicable	Rule for a <i>UCITS investment firm</i> in relation to its non- <i>MiFID business</i> ; otherwise guidance	Not applicable	Guidance, <u>but applies as a rule for an operator of an electronic system in relation to lending</u>
SYSC 7.1.4R	Rule	Rule for a <i>UCITS investment firm</i> ; otherwise guidance	Not applicable	Guidance, <u>but applies as a rule to an operator of an electronic system in relation to lending</u>
SYSC 7.1.4AG	...	...	...	...
...
SYSC 7.1.5R	Not applicable	Rule for a <i>UCITS investment firm</i> in relation to its non- <i>MiFID business</i> ; otherwise guidance	Not applicable	Guidance, <u>but applies as a rule to an operator of an electronic system in relation to lending</u>
SYSC 7.1.6R	Not applicable	Rule for a <i>UCITS investment firm</i> in relation to its non- <i>MiFID business</i> ; otherwise guidance	Not applicable	Guidance, <u>but applies as a rule to an operator of an electronic system in relation to lending</u>
SYSC 7.1.7R	Not applicable	Rule for a <i>UCITS investment firm</i> in relation to its non- <i>MiFID business</i> ; otherwise	Not applicable	Guidance, <u>but applies as a rule to an operator of an electronic system in relation to lending</u>

		guidance		
SYSC 7.1.7AG	Not applicable	Rule for a <i>UCITS investment firm</i> ; otherwise guidance	Not applicable	Guidance, <u>but does not apply to an operator of an electronic system in relation to lending</u>
...

...

Table B: Application of the common platform requirements in SYSC 4 to 10 to MiFID optional exemption firms and third country firms

Provision	COLUMN A MiFID optional exemption firms	COLUMN B Third country firms
<u>SYSC 4 (Note 1)</u>		
...
<u>SYSC 4.1.8G</u>	...	...
<u>SYSC 4.1.8AR</u>	<u>Rule</u>	<u>Rule</u>
<u>SYSC 4.1.8CG</u>	<u>Guidance</u>	<u>Guidance</u>
<u>SYSC 4.1.8DG</u>	<u>Guidance</u>	<u>Guidance</u>
<u>SYSC 4.1.8DAG</u>	<u>Guidance</u>	<u>Guidance</u>
<u>SYSC 4.1.8DBR</u>	<u>Rule</u>	<u>Rule</u>
<u>SYSC 4.1.8DCR</u>	<u>Rule</u>	<u>Rule</u>
<u>SYSC 4.1.8DDR</u>	<u>Rule</u>	<u>Rule</u>
...
<p>Note 1 = <i>SYSC 4.1.8AR to SYSC 4.1.8DDR apply as a rule or guidance, as indicated above, only to an operator of an electronic system in relation to lending.</i></p>		

...

4 General organisational requirements

...

4.1 General requirements

...

4.1.8 G ...

Operators of electronic systems in relation to lending: arrangements to administer loans in the event of platform failure

4.1.8A R (1) An operator of an electronic system in relation to lending must take reasonable steps to ensure that have arrangements are in place to ensure that P2P agreements facilitated by it will continue to be have a reasonable likelihood of being managed and administered, in accordance with the contract terms between the firm and its relevant borrower and lender customers, if at any time it ceases to carry on the activity of operating an electronic system in relation to lending provide the service of managing and administering those P2P agreements.

(2) Under (1), and wherever the requirement in (1) is referenced in the FCA's rules and guidance, the reference to P2P agreements includes any non-P2P agreement included in a P2P portfolio.

(3) The arrangements under (1) must not be designed to prefer any particular customers or class of customers for whom it provides the service of managing and administering P2P agreements or non-P2P agreements.

4.1.8B R ~~Any arrangements made under SYSC 4.1.8AR must be notified to lenders under P2P agreements: [deleted]~~

~~(1) when such arrangements are made; or~~

~~(2) if later, when the lender first becomes a lender under a P2P agreement with that operator; or~~

~~(3) if the arrangements are changed, when that change is made; and~~

~~(4) if the arrangement involves another firm taking over the management and administration of P2P agreements if the operator ceases to operate the electronic system in relation to lending, the notification to lenders must inform lenders of the identity of the firm~~

~~with which the arrangements have been made and how that firm will hold the lenders' money.~~

- 4.1.8C G Arrangements to ensure *P2P agreements* facilitated by the *firm* continue to be managed and administered may include any one or more of the following:
- (1) entering into an arrangement with another *firm* to take over the management and administration of *P2P agreements* if the operator ceases to *operate the electronic system in relation to lending* and, where appropriate;~~or~~
 - (a) obtaining prior and informed consent from lender clients to fund the continued cost of management and administration of their respective loans, for example through increased commissions; and/or
 - (b) obtaining prior and informed consent from lender and borrower clients for the transfer of the service of managing and administration of *P2P agreements* from the firm to that other firm; or
 - (2) holding sufficient collateral ~~in a segregated account~~ to cover the cost of management and administration while the loan book is wound down, ensuring that the collateral is held through a structure that is ring-fenced in the event of the firm's insolvency; or
 - (3) ~~entering into an arrangement for another firm to act as guarantor for the *P2P agreements* which includes a legally enforceable arrangement to meet the costs of the guarantee in full; or [deleted]~~
 - (4) managing the loan book in a way that ensures that income from *P2P agreements* facilitated by the *firm* is sufficient to cover the costs of managing and administering those agreements during the winding down process, taking into account the reduction of the loan pool and fee income from it.
- 4.1.8D G (1) When designing its arrangements, a *firm* should take into account ~~insolvency~~ the general law to ensure that the insolvency of the *firm* does not prejudice the operation of arrangements that the *firm* has put in place.
- (2) A firm should consider the need to obtain professional advice on the adequacy of its arrangements. For example, a firm may benefit from obtaining legal advice or advice from a qualified insolvency practitioner on the likelihood of its arrangements securing the required outcome for continuity of management and administration of *P2P agreements*.
 - (3) In assessing the adequacy of its arrangements, a firm should consider, in particular:

- (a) whether any terms included in relevant contracts as part of its arrangements are enforceable, for example terms in customer, service and supplier contracts;
- (b) the extent to which other practical obstacles could foreseeably prevent the implementation of the arrangements or frustrate the required outcome;
- (c) whether the arrangements make adequate provision for any activities that are ancillary to the management and administration of *P2P agreements* upon which the required outcome is, or could be, dependent; and
- (d) whether its arrangements are designed so as not to produce a better outcome for its customers who are party to *non-P2P agreements* than for customers who are party to *P2P agreements*.

(4) *Firms* are reminded of the disclosure requirements in *COBS* 18.12.26R (Information concerning platform failure).

4.1.8DA G In line with *Principle 11* and *SUP* 15.3.8G (Communication with the appropriate regulator in accordance with *Principle 11*), a *firm* should notify the *FCA* in writing if it is contemplating:

- (1) ceasing to manage and/or administer *P2P agreements* facilitated by it;
- (2) implementing its arrangements under *SYSC* 4.1.8AR; or
- (3) implementing any other arrangements that have a similar purpose.

4.1.8DB R An operator of an electronic system in relation to lending must produce and keep up-to-date a *P2P resolution manual* which contains information about the *firm* that, in the event of the *firm's* insolvency, would assist in resolving the *firm's* business of management and administration of *P2P agreements* that it has facilitated. For these purposes, the reference to *P2P agreements* includes any *non-P2P agreement* included in a *P2P portfolio*. It must, as a minimum, include a written explanation of each of the following:

- (1) how the *firm* conducts the business of management and administration of *P2P agreements* that it has facilitated, what the day-to-day operation of that business entails, and what resources would be needed to continue that business if the *firm* ceased to carry it on, including a specification of:
 - (a) critical staff and their respective roles;
 - (b) critical premises;

- (c) the firm's IT systems;
- (d) the firm's record-keeping systems, including how records are organised;
- (e) all relevant bank accounts and payment facilities;
- (f) all relevant persons outside of the firm, and their respective roles, including any outsourced service providers;
- (g) all relevant legal documentation, including customer, service and supplier contracts; and
- (h) the firm's group, using a structure chart showing:
 - (i) the legal entities in the group;
 - (ii) the ownership structure of those entities; and
 - (iii) the jurisdiction of those entities;
- (2) the steps that would need to be implemented under the arrangements in place under SYSC 4.1.8AR in order for P2P agreements facilitated by the firm to continue to be managed and administered;
- (3) any terms in contracts that may need to be relied on to ensure P2P agreements facilitated by it will continue to be managed and administered under those arrangements;
- (4) how the firm's systems can produce the detail specified in COBS 18.12.29R (Ongoing disclosures) for:
 - (a) each P2P agreement facilitated by it; and
 - (b) each non-P2P agreement facilitated by it that is included in a P2P portfolio.

- 4.1.8DC R An operator of an electronic system in relation to lending must put in place arrangements to ensure that its P2P resolution manual would be immediately available to:
- (1) an administrator, receiver, trustee, liquidator or analogous officer appointed in respect of it or any material part of its property; and
 - (2) the FCA, on request.
- 4.1.8DD R A operator of an electronic system in relation to lending must store its P2P resolution manual in the same place as its CASS resolution pack, if CASS 10 (CASS resolution pack) applies to it.

...

4.3 Responsibility of senior personnel

...

4.3.2 R A management company or an operator of an electronic system in relation to lending, must ensure that:

- (1) its *senior personnel* receive on a frequent basis, and at least annually, written reports on the matters covered by SYSC 6.1.2R to ~~SYSC~~ 6.1.5R, SYSC 6.2.1R, SYSC 7.1.2R, SYSC 7.1.3R and SYSC 7.1.5R to ~~SYSC~~ 7.1.7R, indicating in particular whether the appropriate remedial measures have been taken in the event of any deficiencies; and
- (2) the *supervisory function*, if any, receives on a regular basis written reports on the same matters.

...

6 Compliance, internal audit and financial crime

6.1 Compliance

...

6.1.2 R A management company or an operator of an electronic system in relation to lending must, taking into account the nature, scale and complexity of its business, and the nature and range of financial services and activities undertaken in the course of that business, establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the *firm* to comply with its obligations under *the regulatory system*, as well as associated risks, and put in place adequate measures and procedures designed to minimise such risks and to enable the *FCA* to exercise its powers effectively under the regulatory system and, in respect of a management company, to enable any other competent authority to exercise its powers effectively under the *UCITS directive*.

...

6.1.3 R A management company or an operator of an electronic system in relation to lending must maintain a permanent and effective compliance function which operates independently and which has the following responsibilities:

- (1) to monitor and, on a regular basis, to assess the adequacy and effectiveness of the measures and procedures put in place in accordance with SYSC 6.1.2R, and the actions taken to address any deficiencies in the *firm's* compliance with its obligations; and
- (2) to advise and assist the *relevant persons* responsible for carrying out *regulated activities* to comply with the *firm's* obligations under the

regulatory system.

...

6.1.4 R In order to enable the compliance function to discharge its responsibilities properly and independently, a *management company or an operator of an electronic system in relation to lending* must ensure that the following conditions are satisfied:

- (1) the compliance function must have the necessary authority, resources, expertise and access to all relevant information;
- (2) a compliance officer must be appointed and must be responsible for the compliance function and for any reporting as to compliance required by SYSC 4.3.2R;
- (3) the *relevant persons* involved in the compliance functions must not be involved in the performance of the services or activities they monitor;
- (4) the method of determining the remuneration of the *relevant persons* involved in the compliance function must not compromise their objectivity and must not be likely to do so.

...

6.1.5 R *A management company or an operator of an electronic system in relation to lending* need not comply with SYSC 6.1.4R(3) or SYSC 6.1.4R(4) if it is able to demonstrate that in view of the nature, scale and complexity of its business, and the nature and range of financial services and activities, the requirements under those rules are not proportionate and that its compliance function continues to be effective.

...

6.2 Internal audit

6.2.1 R *A management company or an operator of an electronic system in relation to lending* must, where appropriate and proportionate in view of the nature, scale and complexity of its business and the nature and range of its financial services and activities, undertaken in the course of that business, establish and maintain an internal audit function which is separate and independent from the other functions and activities of the *firm* and which has the following responsibilities:

- (1) to establish, implement and maintain an audit plan to examine and evaluate the adequacy and effectiveness of the *firm's* systems, internal control mechanisms and arrangements;
- (2) to issue recommendations based on the result of work carried out in accordance with (1);

- (3) to verify compliance with those recommendations;
- (4) to report in relation to internal audit matters in accordance with SYSC 4.3.2R.

...

7 Risk control

7.1 Risk control

...

7.1.2 R A UCITS investment firm or an operator of an electronic system in relation to lending must establish, implement and maintain adequate risk management policies and procedures, including effective procedures for risk assessment, which identify the risks relating to the *firm's* activities, processes and systems, and where appropriate, set the level of risk tolerated by the *firm*.

...

7.1.3 R A UCITS investment firm or an operator of an electronic system in relation to lending must adopt effective arrangements, processes and mechanisms to manage the risk relating to the *firm's* activities, processes and systems, in light of that level of risk tolerance.

7.1.4 R The *management body* of a common platform firm or of an operator of an electronic system in relation to lending must approve and periodically review the strategies and policies for taking up, managing, monitoring and mitigating the risks the *firm* is or might be exposed to, including those posed by the macroeconomic environment in which it operates in relation to the status of the business cycle.

...

7.1.5 R A UCITS investment firm or an operator of an electronic system in relation to lending must monitor the following:

- (1) the adequacy and effectiveness of the *firm's* risk management policies and procedures;
- (2) the level of compliance by the *firm* and its *relevant persons* with the arrangements, processes and mechanisms adopted in accordance with SYSC 7.1.3R;
- (3) the adequacy and effectiveness of measures taken to address any deficiencies in those policies, procedures, arrangements, processes and mechanisms, including failures by the *relevant persons* to comply with such arrangements or processes and mechanisms or follow such policies and procedures.

- 7.1.6 R A UCITS investment firm or an operator of an electronic system in relation to lending must, where appropriate and proportionate in view of the nature, scale and complexity of its business and the nature and range of the *investment services and activities* undertaken in the course of that business, establish and maintain a risk management function that operates independently and carries out the following tasks:
- (1) implementation of the policies and procedures referred to in SYSC 7.1.2R to ~~SYSC~~ 7.1.5R; and
 - (2) provision of reports and advice to *senior personnel* in accordance with SYSC 4.3.2R.
- 7.1.7 R Where a UCITS investment firm or an operator of an electronic system in relation to lending is not required under SYSC 7.1.6R to maintain a risk management function that functions independently, it must nevertheless be able to demonstrate that the policies and procedures which it has adopted in accordance with SYSC 7.1.2R to ~~SYSC~~ 7.1.5R satisfy the requirements of those *rules* and are consistently effective.

...

Sch 1 Record keeping requirements

...

Sch 1.2

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...				
SYSC 3.2.20R	...	...	...	...
<u>SYSC 4.1.8DBR</u>	<u>The firm's most recent P2P resolution manual</u>	<u>As stated in rule</u>	<u>When the P2P resolution manual is made or updated</u>	<u>None specified (but see SYSC 4.1.8DCR)</u>
...				

Annex C

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

4 Communicating with clients, including financial promotions

...

4.7 Direct offer financial promotions

...

Non-readily realisable securities

- 4.7.7 R (1) Unless permitted by *COBS* 4.7.8R, a *firm* must not *communicate* or *approve* a *direct-offer financial promotion* relating to a *non-readily realisable security* or a *P2P agreement* to or for *communication* to a *retail client* without the conditions in (2) and (3) being satisfied.
- (2) The first condition is that the *retail client* recipient of the direct offer financial promotion is one of the following:
- (a) certified as a ‘high net worth investor’ in accordance with *COBS* 4.7.9R;
 - (b) certified as a ‘sophisticated investor’ in accordance with *COBS* 4.7.9R;
 - (c) self-certified as a ‘sophisticated investor’ in accordance with *COBS* 4.7.9R;
 - (d) certified as a ‘restricted investor’ in accordance with *COBS* 4.7.10R.
- (3) The second condition is that *firm* itself or the *person* who will *arrange* or *deal* in relation to the *non-readily realisable security* or the *person* who will facilitate a *retail client* becoming a lender under a *P2P agreement* will comply with the *rules* on appropriateness (see *COBS* 10 and 10A) or equivalent requirements for any application or order that the *person* is aware, or ought reasonably to be aware, is in response to the *direct offer financial promotion*.
- 4.7.8 R A *firm* may *communicate* or *approve* a *direct-offer financial promotion* relating to a *non-readily realisable security* or a *P2P agreement* to or for

communication to a retail client if:

- (1) the *firm* itself will comply with the suitability rules (COBS 9 and 9A) in relation to the *investment* promoted; or
- (2) the *retail client* has confirmed before the promotion is made that they are a *retail client* of another *firm* that will comply with the suitability rules (COBS 9 and 9A) in relation to the *investment* promoted; or
- (3) the *retail client* is a *corporate finance contact* or a *venture capital contact*.

4.7.9 R A certified high net worth investor, a certified sophisticated investor or a self-certified sophisticated investor is an individual who has signed, within the period of twelve months ending with the day on which the communication is made, a statement in the terms set out in the applicable rule listed below, substituting “non-readily realisable securities” or “P2P agreements” for “non-mainstream pooled investments”, as appropriate:

- (1) certified high net worth investor: COBS 4.12.6R;
- (2) certified sophisticated investor: COBS 4.12.7R;
- (3) self-certified sophisticated investor: COBS 4.12.8R.

4.7.10 R A certified restricted investor is an individual who has signed, within the period of twelve months ending with the day on which the communication is made, a statement in the following terms, substituting “P2P agreements” for “non-readily realisable securities”, as appropriate:

...

10 Appropriateness (for non-MiFID non-advised services) (non-MiFID provisions)

10.1 Application

...

10.1.2 R This chapter applies to a *firm* which *arranges* or *deals* in relation to a *non-readily realisable security, derivative* or *warrant* with or for a *retail client* or facilitates a *retail client* becoming a lender under a *P2P agreement* and the *firm* is aware, or ought reasonably to be aware, that the application or order is in response to a *direct offer financial promotion*.

...

14 Providing product information to clients

...

14.3 Information about designated investments (non-MiFID provisions)

...

Firms advising on P2P agreements

14.3.7A G Examples of information a *firm advising on P2P agreements* should provide to explain the specific nature and risks of a *P2P agreement* include:

...

14.3.7B G ~~The guidance in COBS 14.3.7AG is relevant both to firms which are operators of electronic systems in relation to lending and firms advising on P2P agreements. [deleted]~~

...

[*Editor's note*: the text in this section takes account of the changes proposed in CP17/27 'Assessing creditworthiness in consumer credit' (July 2017) and the other instrument 'Mortgages and Home Finance (Peer to Peer) Instrument 2018' included in this consultation as if they were made.]

After COBS 18.11 (Authorised professional firms) insert the following new section, COBS 18.12. The text is not underlined.

18.12 Operating an electronic system in relation to lending

Application

18.12.1 R This section applies to *an operator of an electronic system in relation to lending*, but only in relation to a person becoming a lender under a *P2P agreement*.

18.12.2 R This section does not apply in relation to a current account agreement where:

- (1) there is a possibility that the account holder may be allowed to overdraw on the current account without a pre-arranged overdraft or to exceed a pre-arranged overdraft limit; and
- (2) if the account-holder did so, this would be a *P2P agreement* (overrunning).

Purpose

18.12.3 G The purpose of this chapter is to ensure that, in particular, the *firm*:

- (1) prices and values *P2P agreements* fairly and appropriately;
- (2) will prevent lenders being exposed to risk outside of the parameters advertised at the time of investment;
- (3) has a reasonable basis to conclude that a *target rate* can be reasonably achieved; and
- (4) can support the statements made in their disclosures and financial promotions.

Interpretation

18.12.4 R In this section:

- (1) references to a *P2P agreement* include *non-P2P agreements* included in a *P2P portfolio*.
- (2) unless the context otherwise requires, references to lender also include a prospective lender.
- (3) a *firm* is treated as having determined the *price* of a *P2P agreement* in cases other than where the lender and the borrower have entered into a genuine negotiation in order to determine the *price* of that *P2P agreement*.
- (4) references to repayment refer to repayment of capital or payment of interest or other charges (excluding any charge for non-compliance with a *P2P agreement*).

Credit risk assessment

18.12.5 R Where a *firm* determines the *price* of a *P2P agreement* it must undertake a reasonable assessment of the credit risk of the borrower before the *P2P agreement* is made.

18.12.6 R A *firm* must base its *credit risk assessment* on sufficient information:

- (1) of which it is aware at the time the *credit risk assessment* is carried out;
- (2) obtained, where appropriate, from the borrower, and, where necessary, any other relevant sources of information, and

the information must enable the *firm* to carry out a reasonable *credit risk assessment*.

The subject matter of the credit risk assessment

18.12.7 R The *firm* must consider the risk that the borrower will not make one or more repayments under the agreement by the due date.

Scope, extent and proportionality of the credit risk assessment

- 18.12.8 R (1) The extent and scope of the *credit risk assessment*, and the steps that the *firm* must take to satisfy the requirement that the assessment is a reasonable one, based on sufficient information, are dependent upon, and proportionate to, the individual circumstances of each case.
- (2) The *firm* must consider:
- (a) the types of information to use in the *credit risk assessment*;
 - (b) the content and level of detail of the information to use;
 - (c) whether the information in the *firm*'s possession is sufficient;
 - (d) whether and to what extent to obtain additional information from the borrower;
 - (e) whether and to what extent to obtain information from any other sources;
 - (f) whether and to what extent to verify the accuracy of the information that is used; and
 - (g) the degree of evaluation and analysis of the information that is used,
- having regard to the factors listed in (3) where applicable to the agreement.
- (3) The factors to which the *firm* must have regard when complying with (2) and deciding what steps are needed to make the *credit risk assessment* a reasonable one include each of the following where applicable to the agreement:
- (a) the type of *credit*;
 - (b) the amount of the *credit* or, where applicable, the *credit limit*;
 - (c) the duration (or likely duration) of the *credit*;
 - (d) the frequency of the repayments;
 - (e) the amount of the repayments;
 - (f) the annual percentage rate of charge; and
 - (g) any other costs, including any charge for non-compliance with the agreement, which will or may be payable by or on

behalf of the borrower in connection with the agreement.

- 18.12.9 G The *firm* may have regard, where appropriate, to information obtained:
- (1) in the course of previous dealings with the borrower but should consider whether the passage of time could have affected the validity of the information and whether it is appropriate to update it;
 - (2) as part of conducting a *creditworthiness assessment* in relation to a *P2P agreement* in accordance with *CONC 5.5A*; or
 - (3) as part of assessing affordability in relation to a *P2P agreement* comprising a *home finance transaction*, in accordance with *MCOB 11* as modified by *MCOB 15*.

Policies and procedures for credit risk assessment

- 18.12.10 R A *firm* must:
- (1) establish, implement and maintain clear and effective policies and procedures:
 - (a) to enable it to carry out *credit risk assessments*; and
 - (b) setting out the principal factors it will take into account in carrying out *credit risk assessments*;
 - (2) set out the policies and procedures in (1) in writing, and (other than in the case of a *sole trader*) have them approved by its *governing body* or *senior personnel*;
 - (3) assess and periodically review:
 - (a) the effectiveness of the policies and procedures in (1); and
 - (b) the *firm's* compliance with those policies and procedures and with its obligations under *COBS 18.12.5R* to *18.12.8R*;
 - (4) in the light of (3), take appropriate measures to address any deficiencies in the policies and procedures or in the *firm's* compliance with its obligations;
 - (5) maintain a record of each transaction where a *P2P agreement* is entered into sufficient to demonstrate that:
 - (a) a *credit risk assessment* was carried out where required; and
 - (b) the *credit risk assessment* was reasonable and was undertaken in accordance with *COBS 18.12.5R* to *18.12.8R*,

and so enable the *FCA* to monitor the *firm's* compliance with its

obligations under *COBS* 18.12.5R to 18.12.8R; and

- (6) (other than in the case of a *sole trader*) establish, implement and maintain robust governance arrangements and internal control mechanisms designed to ensure the *firm's* compliance with (1) to (5).

Pricing, allocation and portfolio composition

- 18.12.11 R Where a *firm* determines the *price* of a *P2P agreement* it must ensure that that *price* is fair and appropriate.
- 18.12.12 R In order to determine a fair and appropriate *price* for a *P2P agreement* the *firm* must at least ensure:
- (1) the *price* is reflective of the risk profile of the loan; and
- (2) the *firm* has taken into account:
- (a) the time value of money; and
- (b) the credit spread of the *P2P agreement*.
- 18.12.13 R Where a *firm* chooses which *P2P agreements* to facilitate for a lender, it must facilitate only those *P2P agreements* which are in line with the disclosures made under *COBS* 18.12.25R.
- 18.12.14 R Where a *firm* is assembling or managing a *P2P portfolio*, it must ensure that it includes in that *P2P portfolio* only those *P2P agreements* it has determined with reasonable certainty will enable the lender to achieve the *target rate*.
- 18.12.15 R Where a *firm* facilitates an exit for a lender before the maturity date of a *P2P agreement* it must ensure the exit *price* is fair and appropriate.

Risk management framework

- 18.12.16 R (1) Where any of *COBS* 18.12.11R to 18.12.15R applies, a *firm* must have and use a *risk management framework* that is designed to achieve compliance with those *rules*.
- (2) The *firm's risk management framework* must at least:
- (a) be appropriate to the nature, scale and complexity of its business;
- (b) take into account any *credit risk assessment*, *creditworthiness assessment* or assessment of affordability under *MCOB*; and
- (c) categorise *P2P agreements* by their risk, taking into account the probability of default and the loss given default.

- (3) The *firm* must set out the *risk management framework* in writing, and have it approved by its *governing body* or *senior personnel*.

18.12.17 G Where *COBS* 18.12.11R to 18.12.15R do not apply to a *firm*, it would be good practice for it to consider whether, depending on its business model the requirements in *COBS* 18.12.16R(1) to (3) above should be applied.

Monitoring of the risk management framework

18.12.18 R A *firm* with a *risk management framework* must:

- (1) assess, monitor and periodically review the adequacy and effectiveness of the *risk management framework*, including by assessing outcomes against expectations;
- (2) in the light of (1), take appropriate measures to address any deficiencies in the *risk management framework*;
- (3) maintain a record of each transaction where it has used the *risk management framework* to facilitate a *P2P agreement* sufficient to demonstrate that:
 - (a) the *price* of the *P2P agreement* was fair and appropriate in line with the *risk management framework*;
 - (b) where the *firm* chose which *P2P agreements* to facilitate for a lender, that its choice was in line with the *risk management framework*;
 - (c) any inclusion in a *P2P portfolio* was in line with the *risk management framework*,

and so enable the *FCA* to monitor the *firm's* compliance with its obligations regarding the *risk management framework*;

- (4) establish, implement and maintain robust governance arrangements and internal control mechanisms designed to ensure the *firm's* compliance with (1) to (3); and
- (5) allocate to an *approved person* overall responsibility within the *firm* for the establishment and maintenance of an effective *risk management framework* and record that allocation.

Publication of an outcomes statement

18.12.19 R Where a *firm* determines the *price* of *P2P agreements* in any financial year of the *firm*, it must publish an *outcomes statement* within four *months* of the end of each financial year.

18.12.20 R A *firm* must ensure that each *outcomes statement* remains publicly

available for at least 10 years from publication.

Content of an outcomes statement

- 18.12.21 R An *outcomes statement* must include, as applicable for the financial year of the *firm*:
- (1) the expected and actual *default* rate of all *P2P agreements* the *firm* has facilitated by risk category, by reference to the risk categories set out in the *risk management framework*, in line with the requirements in *COBS 4.6* on past and future performance;
 - (2) a summary of the assumptions used in determining expected future default rates; and
 - (3) where the *firm* offered a *target rate*, the actual return achieved.

Information: role of an operator of an electronic system in relation to lending

- 18.12.22 R A *firm* must provide to a lender a description of its role in facilitating *P2P agreements*. That description must include:
- (1) the nature and extent of due diligence the *firm* undertakes in respect of borrowers;
 - (2) a description of how loan risk is assessed, including a description of the criteria that must be met by the borrower before the *firm* considers the borrower eligible for a *P2P agreement*;
 - (3) whether the *firm* will play a role in determining the *price* of a *P2P agreement* and, if so, what role;
 - (4) where lenders do not have the choice to enter into specific *P2P agreements*, what role the *firm* will play in choosing *P2P agreements* for the lender;
 - (5) where a *firm* offers a *P2P portfolio* to lenders, what role it will play in assembling or managing that *P2P portfolio*;
 - (6) an explanation of the *firm's* procedure for dealing with a loan in late payment or default;
 - (7) an explanation of how any tax liability for lenders arising from investment in *P2P agreements* would be calculated;
 - (8) whether the *firm* will play a role in facilitating a secondary market in *P2P agreements* and, if so, what role, including:
 - (a) the procedure for a lender to access their money before the term of the *P2P agreement* has expired and the risk to their investment of doing so; and

- (b) whether the *firm* displays *P2P agreements* that lenders wish to exit and that other lenders may choose to enter into; or
- (c) whether the *firm* decides if the *P2P agreement* should be transferred to another lender without involving either lender in that decision.

Information: financial services compensation scheme

- 18.12.23 R A *firm* must provide confirmation to a lender that there is no recourse to the Financial Services Compensation Scheme.

Information: P2P agreements where the lender selects the agreements

- 18.12.24 R Where lenders have the choice to enter into specific *P2P agreements*, a *firm* must provide them with at least the following information about each *P2P agreement*:
- (1) where the *firm* determines the *price* of *P2P agreements*, the *price* of the *P2P agreement*;
 - (2) where not provided under (1), the annual percentage rate that will be paid by the borrower in respect of that *P2P agreement*;
 - (3) when the *P2P agreement* is due to mature;
 - (4) the frequency of the repayments to be made by the borrower;
 - (5) the amounts of the repayments to be made by the borrower;
 - (6) the total amount payable by the borrower;
 - (7) a fair description of the likely actual return, taking into account fees, default rates and taxation;
 - (8) where the *firm* determines the *price* of *P2P agreements*, details of the *credit risk assessment*, *creditworthiness assessment* or assessment of affordability under *MCOB* carried out;
 - (9) whether the *P2P agreement* is backed by an asset (for example, secured against property developments) and if so, what;
 - (10) fees to be paid by the borrower or the lender, including any deduction from the interest to be paid by the borrower; and
 - (11) where the *firm* determines the *price* of *P2P agreements*, the risk categorisation of that *P2P agreement* and an explanation of that risk categorisation, by reference to the risk categories set out in the *risk management framework*.

Information: P2P agreements where the firm selects the agreements

- 18.12.25 R Where a *firm* chooses which *P2P agreements* to facilitate for a lender, including where a *firm* offers a *P2P portfolio* to a lender, the *firm* must provide the lender with the following information about the *P2P agreements* it may facilitate for the lender:
- (1) the minimum and maximum interest rate that will be payable under any *P2P agreement* that may be facilitated for the lender;
 - (2) the minimum and maximum maturity date of any *P2P agreement* that may be facilitated for the lender;
 - (3) a fair description of the likely actual return, taking into account fees, default rates and taxation;
 - (4) fees to be paid by the borrower or the lender, including any deduction from the interest to be paid by the borrower; and
 - (5) the range and distribution of risk categories that the *P2P agreements* may fall into and an explanation of those risk categories by reference to the risk categories set out in the *risk management framework*.

Information concerning platform failure

- 18.12.26 R (1) A *firm* must notify each lender of the *firm's* arrangements made under SYSC 4.1.8AR to ensure that *P2P agreements* facilitated by it will continue to be managed and administered, in accordance with the contract terms between the *firm* and the lender.
- (a) Where a *firm's* arrangements made under SYSC 4.1.8AR include particular terms in its contracts with lenders, or obtaining particular prior consents from lenders, then the *firm* must clearly identify these and explain how they operate.
 - (b) Where a *firm's* arrangements made under SYSC 4.1.8AR involve another *person* taking over the management and administration of *P2P agreements* if the *firm* ceases to operate the electronic system in relation to lending, the notification must inform lenders of:
 - (i) the identity of the *person* with which the arrangements have been made;
 - (ii) how that *person* will hold the lenders' money; and
 - (iii) whether that *person* is authorised by the FCA and, if it is, which relevant *Part 4A permissions* it holds.
- (2) A *firm* must also explain to each lender the particular risks to the management and administration of *P2P agreements* in the event

of its own *failure*, including:

- (a) the possibility that *P2P agreements* may cease to be managed and administered before they mature;
- (b) the possibility that any *person* involved in the continued management and administration of *P2P agreements* after the *firm* fails may not be subject to the same regulatory regime and requirements as the *firm*, and the resulting possibility that regulatory protections may be reduced or no longer available; and
- (c) the likelihood that the majority of balances due to the lender are those due from borrowers rather than from the *firm* itself, so if the *firm fails* a lender's entitlement to any *client money* held by the *firm* would not include those balances that the *firm* has not yet received from borrowers.

The timing rules

- 18.12.27 R (1) The information to be provided in accordance with *COBS* 18.12.22R to 18.12.23R and 18.12.25R to 18.12.26R must be provided in good time before a *firm* carries on the relevant business for a lender.
- (2) The information to be provided in accordance with *COBS* 18.12.24R must be provided each time before a *firm* facilitates a person becoming a lender under a *P2P agreement*, and in good time before doing so.

Keeping the client up to date

- 18.12.28 R A *firm* must notify a lender in good time about any material change to the information provided under the *rules* in *COBS* 18.12.22R and 18.12.26R. That notification must be given in a *durable medium* if the information to which it relates was given in a *durable medium*.

Ongoing disclosures

- 18.12.29 R A *firm* must ensure that, at any point in time, a lender is able to access details of each *P2P agreement* they have entered into which was facilitated by that *firm*, including:
- (1) the *price* of the *P2P agreement*;
 - (2) where not provided under (1), the annual percentage rate that will be paid by the borrower in respect of that *P2P agreement*;
 - (3) the outstanding capital and interest payments in respect of that *P2P agreement*;

- (4) when the *P2P agreement* is due to mature;
- (5) any fees paid in respect of that *P2P agreement* by the lender or the borrower;
- (6) if the *firm* has carried out a valuation of the *P2P agreement*:
 - (a) the most recent valuation;
 - (b) the valuation date; and
 - (c) an explanation of why the *firm* conducted the valuation.
- (7) a fair description of the likely actual return, taking into account fees, default rates and taxation;
- (8) where the *firm* determines the price of *P2P agreements*, details of the *credit risk assessment*, *creditworthiness assessment* or assessment of affordability under *MCOB* carried out;
- (9) whether the *P2P agreement* is backed by an asset (for example, secured against property developments) and if so, what;
- (10) where the *firm*:
 - (a) determines the *price* of *P2P agreements*;
 - (b) chooses which *P2P agreements* to facilitate for a lender; or
 - (c) offers a *target rate*,

the risk categorisation of that *P2P agreement* and an explanation of that risk categorisation, by reference to the risk categories set out in the *risk management framework*; and
- (11) whether there has been a *default* by the borrower under the *P2P agreement*.

18.12.30 R The *firm* must at least carry out a valuation of the *P2P agreement* following a *default*.

Information: form

18.12.31 R The *documents* and information provided in accordance with *COBS* 18.12.22R to 18.12.26R and *COBS* 18.12.29R must be in a *durable medium* or available on a website (where that does not constitute a *durable medium*) that meets the *website conditions*.

Contingency funds: standardised risk warning

18.12.32 R (1) In addition to any other risk warnings that must be given by a *firm* in accordance with the *rules*, a *firm* must provide the following

risk warning to a lender when it offers a *contingency fund*, modified as necessary to reflect the terminology used by the firm to refer to a *contingency fund*:

“The contingency fund we offer does not give you a right to a payment so you may not receive a pay-out even if you suffer loss. The fund has absolute discretion as to the amount that may be paid, including making no payment at all. Therefore, investors should not rely on possible pay outs from the contingency fund when considering whether or how much to invest.”

- (2) The *firm* must provide the risk warning in a prominent place on every page of each website and mobile applications of the *firm* available to lenders containing any reference to a *contingency fund*.
- (3) Where the lender has not approached the *firm* through a website or mobile application, the risk warning must be provided in a *durable medium* in good time before the *firm* carries on any business for that lender.

18.12.33 R The standardised risk warning must be:

- (1) prominent; and
- (2) contained within its own border and with bold text as indicated.

Contingency funds: published policy

- 18.12.34 R
- (1) A *firm* which offers a *contingency fund* to lenders must have a *contingency fund policy*.
 - (2) The *contingency fund policy* must contain the following information:
 - (a) an explanation of the source of the money paid into the fund;
 - (b) an explanation of how the fund is governed;
 - (c) an explanation of who the money belongs to;
 - (d) the considerations the fund operator takes into account when deciding whether or how to exercise its discretion to pay out from the fund, including examples. This should include:
 - (i) whether or not the fund has sufficient money to pay; and
 - (ii) that the fund operator has absolute discretion in any

event not to pay or to decide the amount of the payment.

- (e) an explanation of the process for considering whether to make a discretionary payment from the fund; and
 - (f) a description of how that money will be treated in the event of the *firm's* insolvency.
- (3) The *contingency fund policy* must be provided on each website and mobile application of firm available to a lender and must be:
- (a) prominent;
 - (b) in an unrestricted part of the website or mobile application; and
 - (c) accessible via a link contained in the standardised risk warning in *COBS* 18.12.32R.
- (4) Where the lender has not approached the *firm* through a website or mobile application this information must be provided in a *durable medium* in good time before the *firm* carries on any business for that lender.

18.12.35 G When deciding whether to pay out from the *contingency fund* a *firm* should take into account fairness to lenders and whether the lender made an active choice about whether or not to participate in the *contingency fund*.

Contingency funds: information when the fund is used

18.12.36 R (1) A *firm* must notify a lender if they receive payment from a *contingency fund*.

(2) This notification must state the amount paid to the lender from the *contingency fund*.

(3) This notification must be provided either:

- (a) at the time the payment is made; or
- (b) on an aggregated basis at least once every three months.

Contingency funds: information about how the fund is performing

18.12.37 R A *firm* which offers a *contingency fund* must make public on a quarterly basis the following facts about how the fund is performing:

- (1) the size of the fund compared to total amounts outstanding on *P2P agreements* relevant to the *contingency fund*;

- (2) what proportion of outstanding borrowing under *P2P agreements* has been paid using the *contingency fund*; and
- (3) a *firm* must:
 - (a) only include the actual amount of money held in the *contingency fund* at the relevant time, net of any liabilities or pay outs agreed but not yet paid; and
 - (b) not include any amounts due to be paid into the *contingency fund* that have not yet been paid into it.

Past performance

- 18.12.38 R A *firm* must ensure that information that contains an indication of past performance only contains information that is reflective of the actual payments made by borrowers to lenders under *P2P agreements*.



Appendix 2

Draft Handbook text

MORTGAGES AND HOME FINANCE (PEER TO PEER) INSTRUMENT 2018**Powers exercised**

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (The FCA’s general rules);
 - (2) section 137R (Financial promotion rules);
 - (3) section 137T (General supplementary powers); and
 - (4) section 139A (The FCA’s power to give guidance).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on [*date*] 2018.

Amendments to the Handbook

- D. The modules of the FCA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2) below:

(1)	(2)
Glossary of definitions	Annex A
Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU)	Annex B
Mortgages and Home Finance: Conduct of Business sourcebook (MCOB)	Annex C
Supervision manual (SUP)	Annex D
Consumer credit sourcebook (CONC)	Annex E

Citation

- E. This instrument may be cited as the Mortgages and Home Finance (Peer to Peer) Instrument 2018.

By order of the Board
[*date*] 2018

Annex A**Amendments to the Glossary**

In this Annex, underlining indicates new text.

Amend the following definition as shown.

tiered product (1) (other than where (2) applies) a product, other than *linked borrowing* or a *linked deposit*, that a *customer* is obliged to purchase through a *mortgage lender* or *reversion provider* as a condition of taking out a *regulated mortgage contract* or *home reversion plan* with that *firm*; or
(2) (in relation to a *customer* of a *P2P platform operator*) a product, other than *linked borrowing* or a *linked deposit*, that a *customer* is obliged to purchase through a *P2P platform operator* as a condition of taking out a *regulated mortgage contract* or *home reversion plan* through that *firm*.

Annex B**Amendments to the Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU)**

In this Annex, underlining indicates new text.

5 Insurance undertakings and home finance providers using insurance or home finance mediation services**5.1 Application and purpose**

...

- 5.1.1A R (1) This chapter also applies to a firm which is a P2P platform operator facilitating a regulated mortgage contract, home purchase plan, home reversion plan or regulated sale and rent back agreement where the lender or provider under that contract does not fall within the definition of a mortgage lender, home purchase provider, reversion provider or regulated sale and rent back firm.
- (2) Where (1) applies, references to a firm using the services of another person consisting of insurance distribution or insurance distribution activity or home finance mediation activity are to be read as references to the P2P platform operator using those services.

...

Annex C

Amendments to the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB)

In this Annex, underlining indicates new text and striking through indicates deleted text.

1 Application and purpose

...

1.2 General application: who? What?

...

Application of MCOB where agreements are facilitated by a P2P platform

- 1.2.22 **R** (1) A provision of MCOB that applies to a mortgage lender, a home purchase plan provider, a home reversion provider or a SRB agreement provider also applies to a P2P platform operator facilitating a regulated mortgage contract, home purchase plan, home reversion plan or regulated sale and rent back agreement where the lender, plan provider, reversion provider or agreement provider does not require permission to enter into the transaction. It applies subject to the provisions in MCOB 15.
- (2) A provision of MCOB that applies to a mortgage administrator or a home purchase administrator also applies to a P2P platform operator administering a regulated mortgage contract or home purchase plan on behalf of a lender or plan provider who did not require permission to enter into the transaction. It applies subject to the provisions in MCOB 15.
- (3) Subject to MCOB 1.2.22R(5), MCOB 1.2.22R(4) applies where:
- (a) a P2P platform operator facilitates an arrangement under which a number of persons provide home finance to a single customer, either individually under separate contracts, or jointly and severally under a single contract;
- (b) by virtue of MCOB 1.2.22R(1), a provision of MCOB (as modified by MCOB 15) applies to the P2P platform operator;
- (c) the provision as modified requires the P2P platform operator to make a disclosure or notification in respect of the entirety of the arrangement; and
- (d) the provision requires one or more of the home finance providers under the arrangement to make the same disclosure

or notification in respect of their individual contract, or their share of the joint and several contract.

- (4) The home finance provider is not required to comply with the provision referred to in MCOB 1.2.22R(3)(d).
- (5) MCOB 1.2.22R(4) does not apply where non-compliance with the provision would be incompatible with EU law.

1.2.23 G (1) The purpose of MCOB 1.2.22R(3) to 1.2.22R(5) is to avoid imposing overlapping requirements on the P2P platform operator facilitating a home financing arrangement and any firms who may participate in it as finance providers, to the extent that is compatible with EU law, in particular the MCD and the Distance Marketing Directive. The table below provides non-exhaustive guidance on MCOB provisions with which a firm may need to comply, notwithstanding MCOB 1.2.22R(3) and MCOB 1.2.22R(4).

- (2) This table belongs to (1).

<u>MCOB provisions</u>	<u>Description</u>
<u>MCOB 5A.4.1R</u>	<u>Provision of a European Standardised Information Sheet (ESIS): timing</u>
<u>MCOB 6.5.6R</u>	<u>Distance contracts with retail customers</u>
<u>MCOB 6.8.5R</u>	<u>Distance contracts with retail customers</u>
<u>MCOB 7.6.1R</u>	<u>Notification of payment changes and other material changes to terms and conditions</u>
<u>MCOB 7.6.7R</u> <u>MCOB 7.6.17R</u>	<u>Further advances</u>
<u>MCOB 7.6.18R</u>	<u>Rate switches</u>
<u>MCOB 7.6.22R</u>	<u>Addition or removal of a party to the contract</u>
<u>MCOB 7.6.28R</u>	<u>Changes to the amount of each payment due</u>

1.2.24 R In this section and in MCOB 15:

- (1) a reference to a P2P platform operator facilitating a regulated mortgage contract, home purchase plan, home reversion plan or regulated sale and rent back agreement is a reference to the platform facilitating persons becoming the lender and borrower, home purchase provider and home purchaser, reversion provider and

reversion occupier, or agreement provider and agreement seller under an agreement which comprises that transaction; and

- (2) a reference to a regulated mortgage contract that is facilitated by a P2P platform operator excludes a CBTL credit agreement.

- 1.2.25 G MCOB 15 contains rules and guidance that apply in relation to regulated mortgage contracts and other home finance transactions facilitated by P2P platform operators. It includes rules that disapply other parts of MCOB that would otherwise apply by virtue of MCOB 1.2.22R(1) or 1.2.22R(2), and rules that apply or modify the application of certain other MCOB provisions in such circumstances. MCOB 15 also includes guidance that will be relevant to such a P2P platform operator whether or not a lender or provider falls within the definition of a mortgage lender, home purchase provider, reversion provider or SRB agreement provider.

...

After MCOB 14 (MCD article 3(1)(b) credit agreements) insert the following new chapter MCOB 15. The text is not underlined.

15 P2P home finance activities

15.1 Handbook provisions which apply in respect of home finance transactions entered into via a P2P platform

- 15.1.1 G The purpose of MCOB 15 is, where a *firm* is a *P2P platform operator* which carries on a *regulated activity* in relation to a *home finance transaction* and where the lender or provider does not require permission to enter into the transaction, to:
- (1) explain the application of MCOB provisions to the *firm*;
 - (2) apply to the *firm rules and guidance* in MCOB that would not otherwise apply, to ensure the protection provided under MCOB to the recipient of home finance is not affected by the status of the provider;
 - (2) make modifications to the way certain provisions of MCOB apply to the *firm*; and
 - (3) disapply specified MCOB provisions from the *firm*.
- 15.1.2 G The effect of CONC 1.2.12R is that a provision of CONC that would otherwise apply in relation to a *regulated mortgage contract* or a *home purchase plan* does not apply where the transaction is facilitated by a *P2P platform operator* and the lender or plan provider does not require permission to enter into it.

15.2 Guidance on the application of MCOB where agreements are facilitated by a P2P platform

- 15.2.1 G (1) Where a *home finance transaction* is entered into with the facilitation of a *firm* which is a *P2P platform operator*, the *firm* is likely to carry on an activity of the kind specified by article 25A, 25B, 25C or 25E of the *Regulated Activities Order* (arranging) and if so *MCOB* provisions applying to that activity will apply to the *firm*. In addition, a *firm* which is a *P2P platform operator* may carry on an activity of the kind specified by article 53A, 53B, 53C or 53D of the *Regulated Activities Order* (advising) and, if so, *MCOB* provisions applying to that activity will apply to the *firm*.
- (2) Where a lender requires permission under article 61(1) of the *Regulated Activities Order* to enter into a *regulated mortgage contract* (that is, where it carries on that activity by way of business and is not excluded or exempt) it will require that permission notwithstanding the fact that it does so with the facilitation of a *P2P platform operator*, and will be responsible for complying with relevant *MCOB rules*. Similarly, where a *person* requires permission under article 63B or 63F of the *Regulated Activities Order* to enter into a *home reversion plan* or a *home purchase plan*, it will require that permission notwithstanding the fact that it does so with the facilitation of a *P2P platform operator*, and will be responsible for complying with relevant *MCOB rules*. It would be open to such a lender or provider to outsource the performance of those obligations to the platform, having regard to the *guidance* on outsourcing in *MCOB 1.2.1AG*.
- (3) Under current legislation, any *person* who enters into a *regulated sale and rent back agreement* requires permission, unless they are a related *person* in relation to the agreement seller within the meaning of article 63J(4)(c) of the *Regulated Activities Order*, or excluded or exempt. However, it should be noted that the relevant legislative provision will cease to have effect on 1 January 2022.
- (4) To secure an appropriate degree of protection for *consumers*, where a *home finance transaction* is facilitated by a *P2P platform operator* and the lender or provider under that transaction does not fall within the definition of a *mortgage lender*, *home purchase provider*, *reversion provider* or *SRB agreement provider*, *MCOB 1.2.22R(1)* applies to the *P2P platform operator* those provisions of *MCOB* that would apply to the lender or provider if it were a *mortgage lender*, *home purchase provider*, *reversion provider* or *SRB agreement provider*.
- (5) For the same reason, where a *regulated mortgage contract* or *home purchase plan* is administered by a *P2P platform operator* on behalf

of a lender or provider who did not enter into the transaction by way of business, *MCOB 1.2.22R(2)* applies to the *P2P platform operator* those provisions of *MCOB* that would apply to the administrator if the transaction had been entered into by way of business.

- (6) This chapter applies *MCOB 3A* (financial promotions etc) to a *firm* which is a *P2P platform operator* in relation to a *home finance transaction*.
- (7) As set out in *MCOB 4.6.1G* a *consumer* may have a right to cancel a *distance contract* for services provided by a *P2P platform operator*.
- (8) *MCOB 5.6.113R* to *5.6.119G* (payments made to mortgage intermediary) are not relevant to a *mortgage intermediary* which is a *P2P platform operator* where the lender does not require permission for entering into a *regulated mortgage contract*. However if there is a *mortgage intermediary* other than the *P2P platform operator* involved in the transaction, those provisions may apply to that intermediary, with the modifications set out in *MCOB 15.4.13R*. The same applies in relation to similar provisions in *MCOB 9.4.119R* to *9.4.125G* (payments to a lifetime mortgage intermediary), with the modifications set out in *MCOB 15.4.15R*, and in *MCOB 9.4.168R* to *MCOB 9.4.174G* (payments to a reversion intermediary), with the modifications set out in *MCOB 15.4.16R*.
- (9) The specified activities of administering a *home reversion plan* in article 63B of the *Regulated Activities Order* and administering a *regulated sale and rent back agreement* in article 63J of that Order apply whether or not the plan or agreement is entered into by way of business and so will be relevant to a *P2P platform operator* carrying on those activities in relation to those products.

15.3 Further provisions about the application of MCOB where agreements are facilitated by a P2P platform

- 15.3.1 R *MCOB 3A* (financial promotions etc) applies to a *firm* which is a *P2P platform operator* communicating or approving a *financial promotion* of a *P2P agreement* which is a *home finance transaction* where the lender or provider does not require permission to enter into the transaction. It applies as though references to *qualifying credit* were references to agreements that would be *qualifying credit* but for the lender not carrying on *regulated activity* by entering into or administering a *regulated mortgage contract*.
- 15.3.2 R *MCOB 13* (arrears, payment shortfalls and repossessions) applies to a *firm* which is a *P2P platform operator* in respect of *regulated mortgage contracts* or *home purchase plans*. It applies as though:
 - (1) references to a *mortgage administrator* or a *home purchase administrator* include a *P2P platform operator*;

- (2) references to *administering a regulated mortgage contract*, *administering a home purchase plan* and *administering a sale shortfall* include a *P2P platform operator* administering such an agreement or shortfall on behalf of a lender or plan provider. References expressing the same concept but using different tenses are similarly included; and
- (3) references to a *firm* taking any action against a *customer* include where the *firm* takes action required by a security trustee holding rights for a lender or provider under a *regulated mortgage contract* or *home purchase plan*.

15.4 Modifications

General modifications

- 15.4.1 R Where a provision of *MCOB* applies to a *firm* which is a *P2P platform operator* and requires the *firm* to refer to the identity of the *mortgage lender*, *home purchase provider*, *reversion provider* or *SRB agreement provider*, the provision may be satisfied by a statement that the loan, plan or agreement is provided by investors facilitated by the *P2P platform operator*.
- 15.4.2 R Where a provision of *MCOB* applies to a *firm* which is a *P2P platform operator* and refers to the “lender’s base mortgage rate”, “the lender’s standard variable rate” or a similar phrase, the *firm* must refer to the *firm*’s base mortgage rate or standard variable rate, as the case may be.
- 15.4.3 R Where a provision of *MCOB* applies to a *firm* which is a *P2P platform operator*, that provision applies as if:
 - (1) references to a *firm* entering into a *home finance transaction* (or any particular type or types of *home finance transaction*) with a *customer* include the *firm* which is the *P2P platform operator* facilitating a lender or provider entering into such a *home finance transaction* with a *customer*;
 - (2) references to a *firm* varying an existing *home finance transaction* (or any particular type or types of *home finance transaction*) include the *firm* which is the *P2P platform operator* varying such an agreement or plan on behalf of a lender or provider; and
 - (3) other references to a *mortgage lender*, *home purchase provider*, *reversion provider* or *SRB agreement provider* include the *P2P platform operator*.
- 15.4.4 R (1) Where a *P2P platform operator* facilitates an arrangement under which a number of *persons* provide home finance to a single *customer* under separate *P2P agreements* comprising separate *home finance transactions*, the provisions of *MCOB* listed in the table in

(2) apply as though a requirement for the *firm* to make a notification or disclosure in respect of a *home finance transaction* is a requirement for the *firm* to make a single notification or disclosure reflecting the aggregate terms and effects of all the *home finance transactions* taken together.

(2) This table belongs to (1).

MCOB provisions	Description
<i>MCOB 2.6A.5AR</i>	Protecting customer's interests: regulated sale and rent back agreements
<i>MCOB 5.5.1R</i>	Provision of illustrations: timing
<i>MCOB 5.8</i>	Pre-application disclosure: home purchase plans
<i>MCOB 5.9</i>	Pre-sale disclosure for regulated sale and rent back agreements
<i>MCOB 6.4.1R</i>	Mortgages: content of the offer document
<i>MCOB 6.5.1R</i>	Tariff of charges
<i>MCOB 6.5.6R</i>	Distance contracts with retail customers
<i>MCOB 6.8.1R</i>	Home purchase plans: offer document
<i>MCOB 6.8.5R</i>	Home purchase plans: distance contracts with retail customers
<i>MCOB 6.9.3R</i>	Regulated sale and rent back agreements: written pre-offer document: Stage One
<i>MCOB 6.9.10R</i>	Regulated sale and rent back agreements: written pre-offer document: Stage Two
<i>MCOB 7.4.1R</i>	Mortgages: disclosure at the start of the contract: disclosure requirements
<i>MCOB 7.5.1R</i>	Annual statement: requirement
<i>MCOB 7.5.10R</i>	Annual statement: additional content if tariff of charges has changed
<i>MCOB 7.6.1R</i>	Notification of payment changes and other material changes to terms and conditions
<i>MCOB 7.6.2R</i>	Notification where the regulated mortgage contract is sold, assigned or transferred

<i>MCOB 7.6.5R</i>	Notification where additional borrowing taken up
<i>MCOB 7.6.7R</i> <i>MCOB 7.6.17R</i>	Further advances
<i>MCOB 7.6.18R</i>	Rate switches
<i>MCOB 7.6.22R</i>	Addition or removal of a party to the contract
<i>MCOB 7.6.28R</i>	Changes to amount of each payment due
<i>MCOB 7.8.1R</i>	Home purchase plans: post-sale disclosure
<i>MCOB 7.8.3R</i>	Home purchase plans: annual statement
<i>MCOB 7.8.6R</i>	Home purchase plans: tariff of charges
<i>MCOB 7.9.1R</i>	Post-sale disclosure for regulated sale and rent back agreements
<i>MCOB 9.3.1R</i>	Equity release: pre-application disclosure
<i>MCOB 9.5.1R</i>	Disclosure at the offer stage for equity release transactions
<i>MCOB 9.6.1R</i>	Disclosure at the start of the contract and after sale for equity release transactions
<i>MCOB 9.7.2R</i>	Disclosure at the start of the contract: lifetime mortgages: disclosure requirements where interest payments are required
<i>MCOB 9.7.4R</i>	Disclosure requirements where the regulated lifetime mortgage contract is a drawdown mortgage with fixed payments to the customer
<i>MCOB 9.7.6R</i>	Disclosure requirements where the regulated lifetime mortgage contract is a drawdown mortgage with variable payments to the customer
<i>MCOB 9.7.8R</i>	Disclosure requirements where a lump sum payment is made to the customer and interest is rolled up
<i>MCOB 9.8.1R</i>	Lifetime mortgages: annual statements: content

<i>MCOB 9.8.3R</i>	Lifetime mortgages: event driven information
<i>MCOB 9.8.5R</i>	Lifetime mortgages: further advances
<i>MCOB 9.8.9R</i> <i>MCOB 9.8.10R</i>	Lifetime mortgages: changes to payments, amounts drawn down and amount owed
<i>MCOB 9.9.1R</i>	Provision of statements: instalment reversion plans
<i>MCOB 9.9.3R</i>	Annual statement for instalment reversion plans: content
<i>MCOB 9.9.4R</i>	Annual statement for instalment reversion plans: additional content if tariff of charges has changed
<i>MCOB 9.9.5R</i>	Event-driven information for instalment reversion plans: material changes
<i>MCOB 13.3.4AR(2)</i>	Information to understand the implications of any proposed arrangement for dealing with payment difficulties
<i>MCOB 13.3.4BR</i>	Information about government schemes to assist borrowers in payment difficulties
<i>MCOB 13.4.1R</i>	Arrears: provision of information to the customer of a regulated mortgage contract
<i>MCOB 13.4.5R</i>	Steps required before action for repossession: provision of updated information
<i>MCOB 13.5.1R</i>	Dealing with a customer in arrears or with a sale shortfall on a regulated mortgage contract: statements of charges
<i>MCOB 13.6.3R</i> <i>MCOB 13.6.4R</i>	Repossessions: if the proceeds of sale are less than the amount due: notification of intent to pursue shortfall
<i>MCOB 13.6.6R</i>	If the proceeds of sale are more than the amount due: informing the customer
<i>MCOB 13.8.1R</i>	Home purchase plans: arrears: provision of information to the customer

- 15.4.5 R Where a provision of *MCOB* applies to a *firm* which is a *P2P platform operator* and requires the *firm* to provide an *illustration*, the *firm* may

provide a *European Standardised Information Sheet (ESIS)* instead. The *ESIS* may diverge from the requirements of *MCOB 5A* where it is necessary to do so to describe the aggregate terms and effects of all the *home finance transactions* comprising the arrangement with the *customer*, taken together.

Protecting customers' interests: home finance transactions

- 15.4.6 R *MCOB 2.6A.-1R* (inclusion and reliance on certain interest terms in agreements) applies to a *firm* which is a *P2P platform operator* as if:
- (1) in place of the *firm* not relying on a term mentioned in that *rule* it referred to the *firm* not taking steps to exercise or enforce rights under such a term; and
 - (2) in place of referring to a term permitting the *firm* to change the rate of interest, it referred to a term permitting that rate to be changed.
- 15.4.7 G A *firm* which is a *P2P platform operator* may comply with *MCOB 4.4A.1R* (1) and *MCOB 4.4A.2R* by providing a *customer* with an explanation in simple, clear terms that the *firm* only offers loans facilitated on its platform.
- 15.4.8 R The “relevant market” referred to in *MCOB 4.4A.2R* in relation to a *firm* which is a *P2P platform operator* is the market for *regulated mortgage contracts* offered by such platforms.
- 15.4.9 R In disclosing remuneration under *MCOB 4.4A.8R* a *firm* which is a *P2P platform operator* is not required to disclose any fees paid by a lender.
- 15.4.10 R The following rules apply subject to the modifications to *MCOB 4.4A* set out elsewhere in *MCOB 15.4*:
- (1) *MCOB 4.4A.9R* (method of providing initial disclosure in all cases);
 - (2) *MCOB 4.4A.12R* (timing of initial disclosure in all cases);
 - (3) *MCOB 4.4A.18R* (additional disclosure under distance contracts); and
 - (4) *MCOB 4.10* (home purchase plans: sales standards).
- 15.4.11 R *MCOB 4.6A.1R* (rolling up of fees etc. into loans) applies to a *firm* which is a *P2P platform operator* facilitating a *regulated mortgage contract* with the modification that, in addition to the *firm* not offering a *regulated mortgage contract* to a *customer*, the *firm* must also not facilitate the entry of a *customer* into a such a contract.
- 15.4.12 R *MCOB 5.5.1R* (timing of provision of mortgage illustration) and *MCOB 5.8.1R* (financial information statement: timing) apply to a *firm* which is a *P2P platform operator* on the basis that the application for that particular *regulated mortgage contract* or *home purchase plan* is made to the *firm*.

- 15.4.13 R Where *MCOB* 5.6 applies to a *firm* which is a *P2P operator* facilitating a *regulated mortgage contract*, and the *illustration* is issued to the *customer* by, or on behalf of, a separate *mortgage intermediary*, references in *MCOB* 5.6.113R to 5.6.119G to a *mortgage lender* must be treated as referring to the *P2P platform operator*.
- 15.4.14 R *MCOB* 6.4.5G (information about advice provided by mortgage intermediary) applies to a *firm* which is a *P2P platform operator* as if the references to the *mortgage lender* are references to the *P2P platform operator* and references to a *mortgage intermediary* are references to a *person* other than the *P2P platform operator*.
- 15.4.15 R Where *MCOB* 9.4 applies to a *firm* which is a *P2P operator* facilitating a *lifetime mortgage*, and the *illustration* is issued to the *customer* by, or on behalf of, a separate *mortgage intermediary*, references in *MCOB* 9.4.119R to 9.4.125G to a *mortgage lender* must be treated as referring to the *P2P platform operator*.
- 15.4.16 R Where *MCOB* 9.4 applies to a *firm* which is a *P2P platform operator* facilitating a *home reversion plan*, and the *illustration* is issued to the *customer* by, or on behalf of, a separate *reversion intermediary*, references in *MCOB* 9.4.168R to 9.4.174R to a *reversion provider* must be treated as referring to the *P2P platform operator*.
- 15.4.17 R Where *MCOB* 11.8 (customers unable to change contract, plan or provider) applies in relation to a *regulated mortgage contract* or *home purchase plan* facilitated by a *P2P platform operator*, *MCOB* 11.8.1E applies as if the reference to a *customer* being unable to enter into a new *regulated mortgage contract* or *home purchase plan* or vary the terms of the existing *regulated mortgage contract* or a *home purchase plan* with the existing or a new *mortgage lender* or *home purchase provider* is a reference to a *customer* being unable to enter into a new *regulated mortgage contract* or *home purchase plan* or vary the terms of an existing *regulated mortgage contract* or *home purchase plan* which is facilitated by the platform.

15.5 MCOB provisions disapplied from P2P platform operators

- 15.5.1 R The following provisions of *MCOB* do not apply to an *MCD mortgage credit intermediary*, where that *firm* is a *P2P platform operator* facilitating a *regulated mortgage contract* where the lender does not require permission to enter into the contract:
- (1) *MCOB* 2A;
 - (2) *MCOB* 3A.5;
 - (3) *MCOB* 3B;
 - (4) *MCOB* 4.4A.3;

- (5) *MCOB 4.4A.3A;*
- (6) *MCOB 4.4A.4;*
- (7) *MCOB 4.4A.5;*
- (8) *MCOB 4.4A.6;*
- (9) *MCOB 4A;*
- (10) *MCOB 5.6.113R to 5.6.119G (payments to mortgage intermediaries) do not apply to a mortgage intermediary which is a P2P platform operator where the lenders under regulated mortgage contracts entered into by a particular borrower do not require permission for entering into regulated mortgage contracts. In this case Section 14 of the illustration must be renumbered 13;*
- (11) *MCOB 5A;*
- (12) *MCOB 6A;*
- (13) *MCOB 7A; and*
- (14) *MCOB 11A.*

15.5.2 G A regulated mortgage contract (including a MCD regulated mortgage contract) where the lender does not act by way of business is not within the scope of the MCD.

Annex D

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

16 Reporting requirements

...

16.11 Product Sales Data Reporting

Application

16.11.1 R This section applies:

(1) in relation to sales data reports, to a *firm*:

(a) ...

(aa) which is a P2P platform operator which facilitates entry into a regulated mortgage contract, home purchase plan, home reversion plan or regulated sale and rent back agreement where the lender or provider does not require permission to enter into the transaction; or

...

(2) in relation to performance data reports, to a *firm*; ~~in which the rights and obligations of the lender under a regulated mortgage contract are vested.~~

(a) in which the rights and obligations of the lender under a regulated mortgage contract are vested; or

(b) which is a P2P platform operator which facilitates entry into a regulated mortgage contract where the lender does not require permission to enter into the transaction.

...

Reporting requirement

16.11.3 R ...

(4) ~~A SRB agreement provider~~ The following types of firm must compile, and keep for at least five years from the end of the relevant quarter, a data report containing the information required by SUP 16.11.5R, but is are not subject to the requirement in (1) to submit a data report (or to the requirement in SUP 16.11.9R):

- (a) a SRB agreement provider; and
- (b) a P2P platform operator which facilitates entry into a regulated sale and rent back agreement where the provider does not require permission to enter into the transaction.

...

16.11.8- R Where P2P platform operator facilitates an arrangement under which a number of persons provide home finance to a single customer, either individually under separate contracts, or jointly and severally under a single contract:

A

- (1) the sales data report and performance data report of the P2P platform operator must include data in respect of the arrangement taken as a whole, as though it comprised a single transaction; and
- (2) the sales data report and performance data report of any firm which is the lender or provider under any separate contract forming part of the arrangement must include data in respect of that contract.

...

16.12 Integrated Regulatory Reporting

...

16.12.4 R Table of applicable rules containing *data items*, frequency and submission periods

(1)		(2)	(3)	(4)
RAG number	Regulated Activities	Provisions containing:		
		applicable data items	reporting frequency/ period	due date
...				
RAG 5	- home finance administration or home finance providing activity - <u>the activity of a P2P platform operator facilitating a home finance transaction, where the lender or</u>	SUP 16.12.18BR and SUP 16.12.18CR	SUP 16.12.18BR and SUP 16.12.18CR	SUP 16.12.18BR and SUP 16.12.18CR

	<u>provider does not require permission to enter into the transaction</u>			
...

...

Regulated Activity Group 5

...

16.12.18 R The applicable *data items*, reporting frequencies and submission deadlines referred to in SUP 16.12.4R are set out in the table below. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period.

B

Description of <i>data item</i>	<i>Data item</i> (note 1)	Frequency	Submission deadline
...
Capital Adequacy (notes 4 and 5)	Section C MLAR	Quarterly	20 <i>business days</i>
...
...			
Note 4	Not applicable if the <i>firm</i> exclusively carries on <i>home finance administration</i> or <i>home finance providing activities</i> in relation to <i>second charge regulated mortgage contracts</i> or <i>legacy CCA mortgage contracts</i> (or both). <u>Also not applicable if the <i>firm</i> is a <i>P2P platform operator</i> facilitating <i>home finance transactions</i>.</u>		
...			

...

Regulated Activity Group 9

...

16.12.28 R The applicable *data items*, reporting frequencies and submission deadlines referred to in SUP 16.12.4R are set out in the table below. Reporting

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frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period.

Description of data item	Data item (note 1)	Frequency		Submission deadline
		Annual regulated business revenue up to and including £5 million	Annual regulated business revenue over £5 million	
...
Capital Adequacy (note 3)	Section D1 RMAR	Half yearly	Quarterly	30 <i>business days</i>
...
...				
Note 3	<p>This item does not apply to <i>firms</i> who only carry on <i>home finance mediation activities</i> exclusively in relation to <i>second charge regulated mortgage contracts</i> or <i>legacy CCA mortgage contracts</i> (or both) and who are not otherwise expected to complete it by virtue of carrying out other regulated activities.</p> <p><u>This item also does not apply if the <i>firm</i> is a <i>P2P platform operator facilitating home finance transactions</i> and is not required to submit it by virtue of carrying out other regulated activities.</u></p>			

...

16 Annex 19BG Notes for completion of the Mortgage Lenders & Administrators Return ('MLAR')

...

INTRODUCTION: GENERAL NOTES ON THE RETURN

...

2. Overview of reporting requirements

The data requirements for *firms* carrying on the *regulated activities* of *home finance providing activity* and *administering a home finance transaction* consist of quarterly, half yearly and annual information. The same data requirements apply to a P2P platform operator facilitating home finance transactions where a lender or provider does not require permission to enter into the transaction, and references to home finance providers or home finance administrators should be read as including such P2P platform operators, where relevant.

This *guidance* deals only with the quarterly requirements, however, which are referred to as the Mortgage Lenders and Administrators Return (MLAR). The remaining data requirements are applied to *firms* through existing rules within the following sections of the *Handbook*:

...

16 Annex 21R

Reporting Fields

This is the annex referred to in SUP 16.11.7R.

1 GENERAL REPORTING FIELDS

The following data reporting fields must be completed, where applicable, for all reportable transactions and submitted in a prescribed format.

Data reporting field	Code (where applicable)	Notes
Reference number of product provider	6 digit number	This field must contain the <i>firm</i> reference number of the <i>firm</i> providing the data report. <u>Where a <i>firm</i> which is a P2P platform operator submits a report in relation to a home finance product in line with SUP 16.11.8-AR, the reference number of the product provider is the reference number of the P2P platform operator.</u>
Reference number of <i>firm</i> that sold the product	6 digit number	This field must contain the <i>firm</i> <i>firm</i> reference number (FRN) of the <i>firm</i> which sold the product. For a <i>firm</i> 's own direct sales, enter the <i>firm</i> 's own FRN. <u>Where a <i>firm</i> which is a P2P platform operator submits a report in relation to a home finance product in line with SUP 16.11.8-AR, the reference number of the <i>firm</i> that sold the product is the reference</u>

		<p><u>number of the <i>P2P platform operator</i>, unless a separate intermediary was also involved.</u></p> <p>For sales via an intermediary (including those facilitated by a <i>P2P platform operator</i> where a separate intermediary is also involved), enter the intermediary's FRN.</p> <p>Where the intermediary is an <i>appointed representative</i>, the FRN of the <i>appointed representative</i> must be reported.</p>
...

Annex E

Amendments to the Consumer Credit sourcebook (CONC)

In this Annex, underlining indicates new text.

1 Application and purpose and guidance on financial difficulties

...

1.2 Who? What? Where?

...

Application where home financing agreements are facilitated by a P2P platform

1.2.12 R *CONC does not apply to a P2P platform operator in circumstances where MCOB applies by virtue of MCOB 1.2.22R(1).*

1.2.13 G *MCOB 1.2.22R(1) provides that a rule in MCOB that applies to a mortgage lender, a home purchase plan provider, a home reversion provider or a SRB agreement provider also applies to a P2P platform operator facilitating a regulated mortgage contract, home purchase plan, home reversion plan or regulated sale and rent back agreement where the lender, plan provider, reversion provider or agreement provider does not require permission to enter into the transaction. It applies subject to the provisions in MCOB 15.*

