Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Dear Sir/Madam,

Call for input: post-implementation review of the FCA's crowdfunding rules

The Financial Services Consumer Panel welcomes the opportunity to respond to the FCA's call for input to the post-implementation review of the FCA's crowdfunding rules.

The Panel has always agreed that crowdfunding rules should be proportionate and not unnecessarily stifle growth. Crowdfunding can help meet demand from both savers and borrowers. However, we recognise there are some risks and this is a good time to review the impact of the regulatory framework and consider whether the remit of the FSCS should be expanded to include peer-to-peer lending.

It appears that crowdfunding has increased overall lending to SMEs. This is positive. Evidence suggests that P2P platforms are not just diverting lending from banks and elsewhere, but are actually increasing the volume of lending available. We would not want to see regulation stifling this essential line of funding.

However, we are concerned at the FCA's use of evidence in the consultation. For example it has taken a Crowdcube scenario as evidence (p24), yet it is unclear what other sources of information have been taken into account. We would be interested to understand what data the FCA receives from platforms to inform its thinking.

Our key concerns about both loan-based and equity based crowdfunding are addressed below.

Quasi-banking

We are concerned that some P2P lending is morphing into a form of banking. Lending to an unknown pool of borrowers, with due diligence undertaken by the platform rather than the lender, is essentially banking. P2P lenders are also engaging in maturity transformation by using illiquid loans to back products which make promises of "quick" or 30-day access. In these cases, the platform should take responsibility for due diligence, and hold reserves to mitigate the risk of default/liquidity. If platforms are not bearing the risk of default, this needs to be made absolutely clear to consumers. Some P2P platforms are taking assets that are correlated, risky and illiquid and making claims to consumers that the returns are diversified, safe and liquid. Platforms need to make it clear to consumers that they may not be able to get their money back when they thought they could at the outset of the contract.

Real estate lending

We believe that real estate lending via crowdfunding platforms is not markedly different from conventional commercial property funds when it comes to liquidity and the risk of capital loss. Real estate lending accounts for 40% of business P2P loans. This seems to us to be another example of quasi-banking.

Wholesale money

Wholesale money is an important feature of P2P lending to SMEs. There are some examples of banks putting SME loans through P2P platforms as they do not have the infrastructure to carry out the due diligence. This means banks are contracting out the lending process.

Once asset managers put money into P2P platforms there are risks, including:

- Platforms might lose interest in serving retail lenders (the banks have stopped trying to attract retail money as they have enough through Funding for Lending);
- Asset managers may want to skew the loan portfolio towards higher risk/higher yield borrowers, as they can factor in a percentage loss across the wider amounts they are putting in; and
- The customers of the asset managers may not realise that their investments are being placed into high risk assets.

Secondary markets / Insider trading / market abuse

The P2P sector is not subject to any rules on insider trading / market abuse. This means that insiders could take advantage of non-public information about the health of the firms/individuals lent to by the platform or the stability of the platform itself to disadvantage other investors. These risks are increased as more and more platforms operate or offer access to secondary markets enabling investors to buy and sell loans or pieces of loans. The availability of secondary markets are also used to make claims to consumers that they can have early access to their money.

"Asset-backed" investments

Some P2P platforms (and other unregulated purveyors of investments) are making claims that their products are "asset-backed". As part of the post-implementation review the FCA could examine the regulatory perimeter for these type of investments and whether some should be authorised as asset managers, Collective Investment Schemes or P2P platforms.

Investor understanding

The risk warnings on equity crowdfunding should be upfront, clear and standardised, in plain English, and cover both capital and liquidity risk. Consumers should also be warned that FCA regulations require them to certify that they are not putting more than 10% of their net investible assets into non-readily realisable securities. It is not clear how the FCA monitors and enforces this rule. One way to do this, and to highlight the potential risks at the same time, could be for P2P lenders to have an appropriateness test.

Equity-based crowdfunding

There have been examples of companies seeking to raise several million pounds via crowdfunding platforms for the sort of projects that they might previously have sought venture capital or angel investment, both of which spread risks, as they understand that most projects will fail; only a few projects will make them a lot of money. Investors are likely to understand that crowdfunding for something like a local theatre may well essentially be a charitable donation, so will only put in sums they are willing to lose. However, bigger SMEs are turning to crowdfunding as a quicker, simpler and cheaper way of investing. More should be done to ensure investors are spreading their risks sufficiently.

ISA wrapper

We are concerned that consumers may see ISA eligibility as meaning their investment will be safe, offer fair returns and be covered by the FSCS. More needs to be done to inform consumers that, with crowdfunding investments, none of the above may be true.

Financial promotions and adequate disclosure

We believe there is still a lot to be done to ensure firms comply with fin prom and disclosure rules. Consumers may see that a firm is FCA regulated (even if it only has interim permissions) and interpret that as meaning their money is safe, or they have recourse to redress. It is therefore particularly important that promotions are clear and not misleading at all times. There are still financial promotions and websites for P2P platforms which use terminology like safe and secure when describing the service. There are also claims made about the potential returns available when it is not clear how they have been calculated, whether they are based on actual performance or are merely aspirations, or whether they take into account potential default rates. These claimed returns pose particular risks where P2P loans/platforms are included in the same comparison tables as FSCS-protected savings accounts. Comparison sites promoting P2P products should be prohibited from including these in tables alongside FSCS-protected savings accounts.

Residential mortgages

Platforms could offer residential mortgages under the current rules. Given all of the work the FCA has done in recent years in this market, we would not want to see firms being able to circumvent the rules on responsible lending, affordability requirements and forbearance.

Treatment of borrowers

Platforms must fully conform to CONC rules with their affordability assessments, treatment of people in arrears and treatment of defaulters etc. The FCA should not allow poor treatment of borrowers to go unnoticed as a result of its supervisory approach to smaller firms.

Transparency

Finally, as in all other areas of financial services, we urge the FCA to be more transparent by publishing more information in relation to warning notices and early intervention. More information available enables other firms to learn lessons. Moreover, consumers may believe a firm’s conduct is fine, if information to the contrary is not available. In an industry that has a large and growing number of new entrants, one of the ways these new providers learn what conduct is expected of them is through being aware of mistakes and misconduct made by others. Similarly, it might also be helpful to new entrants going through the authorisations process if they were given sight of previous standard ‘Dear CEO’ letters, to ensure previous poor practices are not allowed to re-enter the market inadvertently.

Yours sincerely

Sue Lewis
Chair, Financial Services Consumer Panel