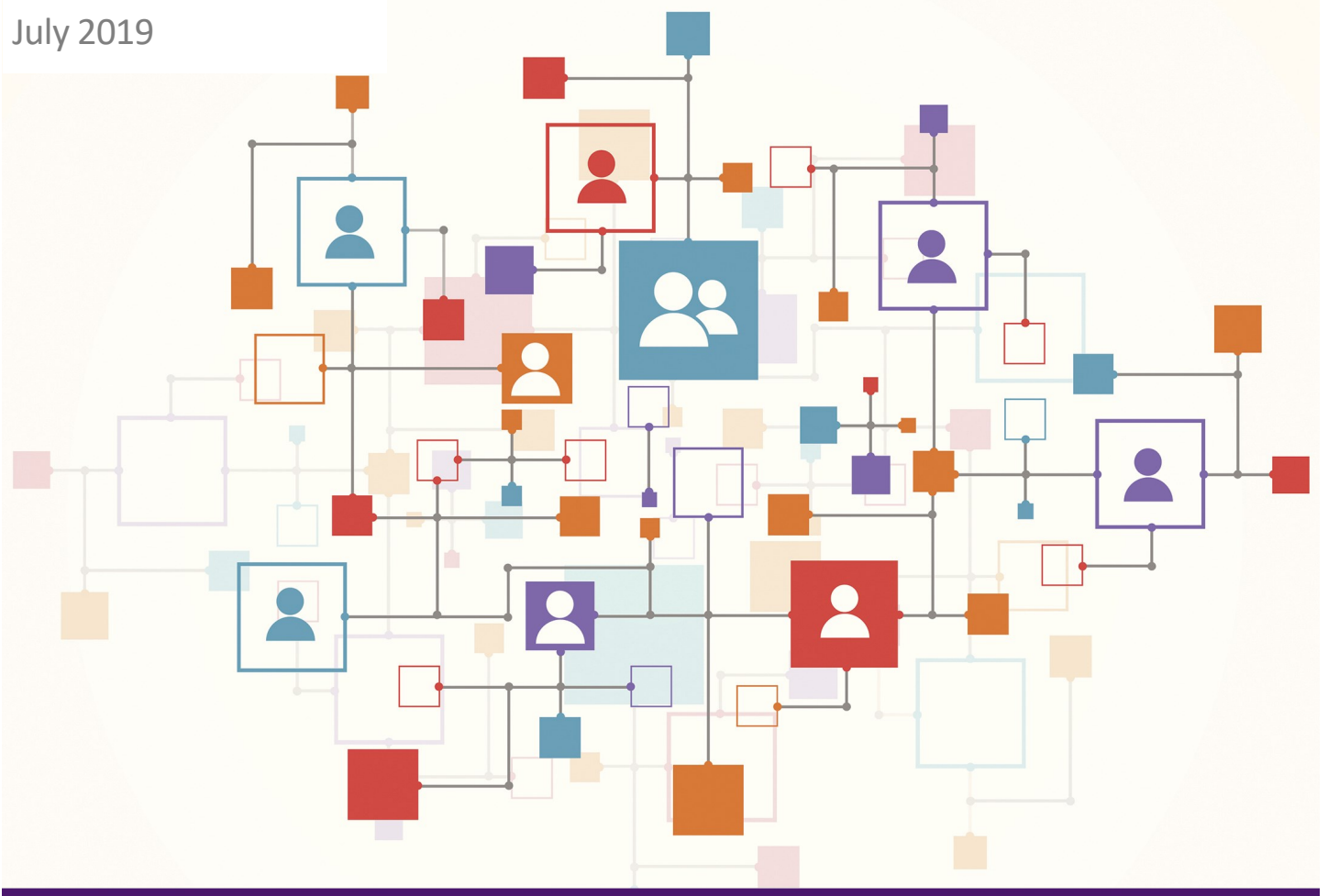


P2Ps—What you need to know about the new FCA Rules

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The Financial Conduct Authority (FCA) has published new rules for loan-based P2P platforms¹, which will come into effect on 9 December 2019.

The introduction of the new rules is timely, coming after the collapse last month of Lendy, a P2P platform that facilitated loans to property developers.

The rules require changes to marketing practices and a wide-ranging review of existing governance and policies.

They have the potential to create significant risks for P2P platforms if not implemented properly.

In this note, we summarise the new rules and highlight the issues for P2Ps to focus on as they prepare for implementation over the coming months.²

1. Marketing Restrictions

The key change which is likely to have the greatest impact on the loan-based P2P business model is the introduction of new marketing restrictions for retail clients.

Direct-offer financial promotions in P2P loans can only be made to retail clients who:

- Within the last 12 months have been certified or self-certified as "sophisticated investors" or "high net worth investors";
- Within the last 12 months have confirmed that they will not invest more than 10% of their net investible assets in P2P agreements; or
- Have received investment advice from a regulated firm.

These restrictions currently apply to direct offer financial promotions of non-readily realisable securities and have the potential to reduce the scale of investment into P2Ps.

Their extension to P2P loans reflect the FCA's concern that only retail investors who are capable of understanding and bearing the risk of loss should invest in P2P agreements.

2. Appropriateness Assessment

Where a retail customer has not received advice from another regulated firm, the P2P will be required to assess whether the investor has the necessary knowledge to understand the risks involved in relation to its investment in P2P loans.

There is a long list of areas of knowledge to be checked. The issue we see here is the discretion that each P2P has in determining the correct checks on understanding.

The FCA states that a "tick box" approach will not be adequate, but P2Ps are left to devise their own method of checking knowledge.

This lack of certainty leaves P2Ps open to risk if a problem subsequently arises with the P2P loan.

P2Ps should seek expert advice on appropriateness tests to show that due skill and care has gone into devising the relevant process.

We recommend considering the appropriateness tests of more traditional regulated investments for guidance.

3. Wind-Down Arrangements and the Resolution Manual

The existing rules in relation to platform failure have been strengthened

Where appropriate, P2Ps must obtain prior and informed consent from investor and borrower clients to the transfer of servicing arrangements to another provider in a wind-down scenario, and (from lender clients) to the increased cost of the servicing.

They must also provide lenders with information about the consequences of platform failure.

A P2P must maintain a resolutions manual containing information to assist in resolving the management and administration of P2P agreements, should it become insolvent.

This is in addition to any CASS resolution pack that the platform is required to keep.

The manual must include an explanation of critical staff and their roles, record-keeping systems, outsourced service providers, and any back-up servicing arrangements.

P2Ps should seek advice from lawyers and/or insolvency professionals when considering their wind-down plans to ensure compliance with the new rules.

Investor disclosure and terms and conditions will almost certainly need to be amended.

1. Policy Statement PS19/14 June 2019: Loan-based ('peer-to-peer') and investment-based crowdfunding platforms: Feedback to CP18/20 and final rules.

2. The new rules also apply to investment-based crowdfunding platforms and extend MCOB to P2Ps which offer home finance products with immediate effect. Those changes are beyond the scope of this note.

Importantly, the wind-down arrangements must not prefer institutional investors to retail investors, which is an issue we have seen arise in certain transactions.

In planning wind-down arrangements, P2Ps should also consider the FCA's Wind-down Planning Guide and its Dear CEO Letter, dated 7 March 2019.

4. Changes to Conduct of Business Rules for P2Ps

(a) Pricing and Target Rates

Depending on the context, the new rules refer to the "price" of a P2P loan as meaning either its interest rate or its transfer value.

P2Ps must ensure that the price of a P2P loan is fair and appropriate and carry out a proper credit assessment.

They must review the price of a P2P loan when it is originated, when it becomes impaired or defaults, or when facilitating a secondary sale.

A P2P that selects or manages loans in a portfolio and advertises a target rate must ensure that the portfolio contains loans that it is reasonably certain will achieve that rate and must use appropriate data and robust modelling to back this up.

(b) Outcomes Statement

P2Ps must publish an outcomes statement within four months of the end of each financial year.

The outcomes statement must set out the actual and expected default rates of P2P loans using the categories of loan referred to in its risk management framework.

Where a P2P statement offers a target rate of return, the outcome statement must also specify the actual rate achieved.

(c) Disclosure

The new rules require P2Ps to provide potential investors with a description of the P2P's role in facilitating P2P loans, including the extent of the due diligence it conducts on borrowers and whether it will facilitate a secondary market.

There are also extensive initial and ongoing disclosure requirements covering the P2P loans, any contingency fund and the consequences of platform failure.

Most of the required disclosure is either factual or standardised risk wording, but some requires an element of judgement; for example, the P2P must provide a fair description of the likely actual return for investors.

5. Governance

The FCA wants P2P business to be structured in a way that promotes treating customers fairly and, to achieve this, it has extended a number of existing rules relating to governance in SYSC (the FCA's Senior Management, Systems and Controls sourcebook) to cover P2Ps.

(a) Risk Management Framework

In order to comply with their new obligations in relation to pricing and target rates, P2Ps are required to put in place a risk management framework and to categorise P2P loans by risk.

They must also maintain records showing how that risk management framework is used in practice and review the framework periodically.

(b) Organisational Requirements

Under the new rules, most P2Ps will be required to have an independent compliance function.

In addition, where it is appropriate and proportionate, the P2P must maintain an independent internal audit function and/or an independent risk function.

(c) Senior Management and Supervision

The new rules require the senior personnel and supervisory function of a P2P to receive compliance reports on a regular basis.

The new rules emphasise the responsibility of senior management for compliance and this is reinforced by the extension of the FCA's Senior Managers and Certification Regime to P2Ps, which also comes into effect in December.

6. Conclusion

The new rules are highly prescriptive in some areas, for example, in relation to investor disclosure.

Therefore, some adjustment to existing policies and procedures will inevitably be required, even for those P2Ps that already have comprehensive rules in place.

In other areas, such as assessing investor appropriateness and pricing methodology, P2Ps have a great deal of discretion. As a result, investors suffering losses in relation to P2Ps loans may have a number of avenues to explore if they wish to bring a claim against their provider.

This may be positive from the standpoint of investor protection, but it is also likely to accelerate the current trend in the market towards institutional rather than retail funding.

Time is already short given that P2Ps will need to update their systems and portals to deal with the new rules.

Fieldfisher has extensive experience of advising on P2Ps and other financing platforms and can help. If you would like to discuss any aspect of this note, please contact either Marsili Hale, Partner, Finance (marsili.hale@fieldfisher.com) or Stephen Moller, Partner, Finance (stephen.moller@fieldfisher.com).

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