



Peer-to-peer Lending:

**APPROACH TO IMPLEMENTATION OF THE
APPROPRIATENESS TEST**

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1. Glossary

Appropriateness Test - the proposed instrument for Peer-to-peer Platforms to fulfil the obligations of COBS 10 in respect of applications or orders that are in response to a Direct Offer Financial Promotions.

Article 36H agreement - as defined in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

COBS - [Conduct of Business Sourcebook](#).

CP18/20 - [The FCA Consultation Paper entitled](#) Loan-based ('peer-to-peer') and Investment-based Crowdfunding platforms: Feedback on our post-implementation review and proposed changes to the regulatory framework.

Debt-based Securities - debt securities that are included in Investment-based Crowdfunding.

Direct Offer Financial Promotion - as defined in the FCA Handbook.

FCA - the Financial Conduct Authority.

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**.

Non-advised - means a customer lends money via a P2P Agreement without receiving advice from an FCA authorised Financial Adviser.

Peer-to-peer (P2P) Loans - means an article 36H agreement (within the meaning of article 36H of the [Regulated Activities Order](#)).

Peer-to-peer (P2P) Agreement - as defined in the FCA Handbook <https://www.handbook.fca.org.uk/handbook/glossary/?filter-title=p2p>

Peer-to-peer (P2P) Platforms - firms directly authorised by the FCA with permissions to operate an electronic platform for the purposes of lending

Product - means the construct of a P2P Platform that is made available to customers in order that they may invest in a P2P Loan.

PS19/14 – [The FCA Policy Statement](#); Loan-based ('peer-to-peer') and investment-based crowdfunding platforms: Feedback to CP18/20 and final rules

2. Introduction

Following a review of the P2P industry the FCA have published their final rules. In arriving at these rules the FCA's aim was to ensure that only consumers capable of understanding the risks and of bearing the consequences should invest in P2P Agreements. As a result, they have sought to develop a regulatory framework that balances what they consider is the need for a greater degree of protection for consumers with a desire that the market could continue to develop and remain competitive.

In [CP18/20](#) the FCA proposed extending the appropriateness rules to P2P Loans provided on a Non-advised basis. <https://www.fca.org.uk/publication/consultation/cp18-20.pdf>.

In a subsequent Policy Statement [PS19/14](#), the FCA confirmed that it will be introducing an appropriateness assessment in circumstances where no advice has been given to an investor.

Where firms are selling P2P Loans on a Non-advised basis, COBS 10 requires them to take steps to determine whether those Products are appropriate for the consumer in question.

This document sets out a recommended approach to performing such assessments (Appropriateness Test), which may be of value to P2P Platforms who are subject to these rules for the first time.

This document is based upon an appropriateness framework developed by TISA members for MiFID II. TISA members who are P2P Platforms have reviewed that framework and discussed how appropriateness could be applied to P2P lending. The aim of this paper is to provide P2P Platforms with guidance to assist them to implement an Appropriateness Test which is clear for consumers, fairly represents the risks, is consistent across the industry and is not excessively onerous for P2P Platforms to implement.

This document is based on COBS 10 and is intended to complement existing FCA regulation and guidance, relating to pre-sale disclosure, product design and product governance. P2P

Platforms should refer to the specific FCA rules for further information. An appropriateness assessment is an additional requirement and does not replace or alter any required disclosures nor enable the sale of a Product into a target market for which it is not designed or suitable.

3. Scope

There is an existing TISA guide document “MiFID II – Appropriateness APPROACH TO IMPLEMENTATION” that covers MiFID II instruments which includes shares and debentures (including Debt-based Securities). However, P2P Agreements are not covered as they are not MiFID Annex I Section C Financial Instruments and P2P lending is not subject to MiFID II.

Therefore, the scope of this guide is to cover P2P Agreements as they were not within the scope of MiFID II. P2P Agreements are also known as article 36H agreements (as defined in the Regulated Activities Order), P2P Agreements (in the FCA Handbook) and Loan-based Crowdfunding in other FCA documents. P2P Platforms with broader product offerings may refer to both guides.

This document does not address the concept of suitability which applies to advised investments. The majority of P2P Agreements are entered into by customers who are investing on an execution-only basis.

4. General principles

The purpose of the appropriateness assessment is to determine whether a customer has the necessary knowledge and experience to understand the risks involved in relation to the investment so as to enable the FCA-authorized firm to assess whether the service or Product envisaged is appropriate for the client. A good assessment should:

- be written in plain language and avoid the use of industry-specific technical terms without explanation;
- be brief enough to ensure the customer engages with the questions properly and is not encouraged to skip questions or falsify answers;

- address complexity and risk factors from the customer perspective and not that of the firm;
- be specific to the Product, Product group, and / or P2P Platform as appropriate;
- avoid binary (yes / no) answers; and
- be media-neutral, so that it can be used in an online process, paper-based process or any other medium that a firm may choose (providing it meets the necessary record keeping requirements).

5. Responsibility for assessment

Responsibility to conduct the appropriateness assessment falls on the firm who ‘facilitates a retail client becoming a lender under a P2P Agreement’¹ on a Non-advised basis. In the majority of instances this would be the P2P Platform.

Where the P2P Platform holds a relationship with a third-party who introduces customers to the P2P Platform and facilitates them entering into a P2P Agreement, it is the responsibility of the P2P Platform to assess the consumer onboarding journey and determine the appropriate application of the Appropriateness Test.

6. Application

The FCA intends to amend COBS 10 “Appropriateness (for non-MiFID and non-insurance-based investment products non-advised services) (non-MiFID and non-insurance-based investment products provisions)” so that it now applies also to firms that facilitate retail clients becoming lenders under a P2P Agreement. In summary, this requires firms to:

- assess appropriateness of retail clients becoming lenders;
- warn clients if products may be inappropriate; and
- maintain records of Appropriateness Tests undertaken.

¹ Proposed amendment to COBS 10.1.2

However, it only applies when the firm is aware, or ought reasonably to be aware, that the application or order is in response to a Direct Offer Financial Promotion. A Direct Offer Financial Promotion is one that contains:

- an offer by the firm or another person to enter into a controlled agreement² with anyone who responds to the communication; or
- an invitation to anyone who responds to the communication to make an offer to the firm or another person to enter into a controlled agreement;
- and which specifies the manner of response or includes a form, by which any response may be made (as defined in the FCA rules).

When should the assessment take place?

The P2P Platform may be flexible about the placement of the appropriateness assessment in the customer journey, but, in any event, the assessment must take place before an investment is made.

The P2P Platform may choose to perform appropriateness assessments when a customer opens an account. If the P2P Platform adopts this approach, it should ensure the appropriateness assessment gives sufficient regard to the potential differences between Products that are available on the platform.

COBS 10 requires P2P Platforms to determine whether retail customers have the necessary experience and knowledge in order to understand the risks involved in relation to the Product offered or demanded (the appropriateness assessment). It also requires P2P Platforms to maintain records of appropriateness assessments. COBS 10 does not prohibit P2P Platforms from selling Products to customers, or executing customer orders, where they determine that the Product may not be appropriate following the assessment and the customer asks to proceed (see Section 9 for more information).

² As defined by the FCA in <https://www.handbook.fca.org.uk/handbook/glossary/G223.html>

However, continuing to execute the order should **not** be automatic and if a customer asks a P2P Platform to go ahead with a transaction, despite being given a warning by the P2P Platform, it is for the P2P Platform to consider whether to do so having regard to the circumstances. P2P Platforms must first, **before executing the order**, provide a relevant warning to the customer in this case, or where the customer did not provide sufficient information to determine if the Product is appropriate.

Complex and Non-complex Investments

The rules on appropriateness differ between “complex” and “non-complex” investments. In short, the appropriateness assessment is not required in relation to certain non-complex investments.

The P2P sector is diverse with many different Product offerings and models. Generally, P2P Loans are considered to be “complex” which require an Appropriateness Test to be undertaken, but firms should make their own evaluation. “Non-complex” Products could potentially be exempt from the appropriateness assessment.

For P2P Loans to be “non-complex” they would need to fit the definition of a [financial instrument](#) and satisfy the criteria in [COBS 10.4](#).

7. Existing investors

The FCA has stated that it is not its intention to trigger divestment of existing investments (investments made before the implementation of an Appropriateness Test or the 9th December 2019, whichever comes first). Therefore, existing investments are exempt from the appropriateness assessment and may continue unimpacted. This exemption also covers automatic reinvestment instructions for existing funds as these are not classed as new investments.

However, the exemption for existing investments applies to the investments themselves as opposed to the customer. If the same customer wishes to make a new investment after 9th December 2019, this would trigger an Appropriateness Test.

P2P Platforms should consider the possibility that an existing customer may not pass the Appropriateness Test. This poses a question on how to treat the customer in respect of both their existing investment and any new investment. There is no prescribed treatment specifically for an existing customer who 'fails' the Appropriateness Test so it is for the P2P Platform to determine which action to take to deliver outcomes that are in the customer's best interest. See Section 9 for more information.

The P2P Platform may consider applying more than one Appropriateness Test if it is in the customer's interest. This may be the case if, for example, the P2P Platform has Products which differ materially one from the other (see Section 8), if the Product has changed since the customer completed the Appropriateness Test or if a new Product(s) is made available to the customers.

8. Appropriateness Test Considerations

An Appropriateness Test must determine that the customer has the necessary knowledge and experience in the P2P Agreement or service offered before the customer is able to invest. COBS 10.2.9³ states:

“When determining whether a client has the necessary knowledge to understand the risks involved in relation to a P2P agreement or a P2P portfolio, a firm should consider asking the client multiple choice questions that avoid binary (yes/no) answers and cover, at least, the following matters:

- a) the nature of the client's contractual relationships with the borrower and the firm;*
- b) the client's exposure to the credit risk of the borrower;*
- c) that all capital invested in a P2P agreement or P2P portfolio is at risk;*
- d) that P2P agreements or P2P portfolios are not covered by FSCS;*
- e) that returns may vary over time;*

³ Rule due to come into force 9th December 2019

- f) *that entering into a P2P agreement or investing in a P2P portfolio is not comparable to depositing money in a savings account;*
- g) *the characteristics of any:*
 - i. *security interest, insurance or guarantee taken in relation to the P2P agreements or P2P portfolio; or*
 - ii. *risk diversification facilitated by the firm; or*
 - iii. *contingency fund offered by the firm; or*
 - iv. *any other risk mitigation measure adopted by the firm;*
- h) *that any of the measures (such as those in (g)) adopted by the firm cannot guarantee that the client will not suffer a loss in relation to the capital invested;*
- i) *that where a firm has not adopted any risk mitigation measures (such as those in (g)), the extent of any capital losses is likely to be greater than if risk mitigation measures were adopted by the firm;*
- j) *illiquidity in the context of a P2P agreement or P2P portfolio, including the risk that the lender may be unable to exit a P2P agreement before maturity even where the firm operates a secondary market;*
- k) *the role of the firm and the scope of its services, including what the firm does and does not do on behalf of lenders; and*
- l) *the risks to the management and administration of a P2P agreement or P2P portfolio in the event of the firm's becoming insolvent or otherwise failing."*

9. Results of the Appropriateness Test

In extending the appropriateness rules to P2P Loans the FCA has stated its objective "to ensure that only consumers capable of understanding the risks [...] invest in P2P agreements".

Where the P2P Platform, via the Appropriateness Test, is able to assess that the customer understands the matters of the investment and the risks involved, it may allow the customer to proceed to invest.

However, it is important to consider that while the Appropriateness Test may yield a positive assessment, it may not be as reliable when assessing customers that have not completed the test successfully. This is because the P2P Platform cannot assume the reasons why a customer was not successful in completing the test. In this context the Appropriateness Test is not an exam with binary pass/fail results.

The P2P Platform may consider that the results of the test will indicate whether the customer:

- Understands the matters of the investment; or
- Does not understand and is not capable of understanding; or
- Does not understand but is capable of understanding.

If a customer has failed to demonstrate knowledge and experience, the P2P Platform could consider how they provide additional information to the customer in order to educate the customer. Upon providing the additional information, the P2P Platform must still make an appropriateness assessment of the customer's knowledge and experience before permitting the customer to proceed.

Where a P2P Platform is unable to ascertain if the Product is appropriate, it may:

- prohibit investment by the customer indefinitely; or
- prohibit investment by the customer for a specific period of time; or
- upon the customer's request, permit the investment subject to appropriate warning and necessary disclosure (giving proper consideration to the above and the P2P Platform's duty to act in a customer's best interests);
- introduce a scaled response considering both the outcome of the assessment (including marginal results) and the complexity factors of a given Product or business model.

Where a P2P Platform chooses to present a warning to customer that have been unable to demonstrate their knowledge and experience, the warning should properly reflect the risks and nature of the Product. P2P Platforms must take a view on the degree, to which the customer did not demonstrate sufficient understanding of the Product to satisfy the assessment prior to proceeding further or set out where insufficient information was provided to the P2P Platform. The warning may also be provided in a standardised format.

The decision whether to permit the customer to continue with the investment is ultimately a matter for the P2P Platform and should be considered under COBS 10.

P2P Platforms should not make a statement of appropriateness saying whether or not the investment is appropriate for an customer.

10. Record Keeping

The relevant record keeping requirement is set out in COBS 10.7 Record keeping and retention periods for appropriateness records.

P2P Platforms should maintain records of the appropriateness assessments they have undertaken for a minimum of five years. The records should include:

- the Appropriateness Test questions;
- the result of the appropriateness assessment;
- any warning given to the customer where the investment service or product purchase was assessed as potentially inappropriate for the customer, whether the customer asked to proceed with purchase despite the warning and, if applicable, whether the firm accepted the customer's request to proceed with the purchase; and
- any warning given to the customer where the customer did not provide sufficient information to enable the firm to undertake an appropriateness assessment, whether the customer asked to proceed with purchase despite this warning and, if applicable, whether the firm accepted the customer's request to proceed with the purchase.

11. Appropriateness Test Example Questions and Answers

Below are examples of the questions and answers that P2P Platforms may put to customers in the Appropriateness Test. These are purely illustrative and are not intended to provide guidance. P2P Platforms may choose to adopt any variation to content, format and number of questions. It is for each P2P Platform to consider their individual business model and Product, and how this will be understood by their customers in the Appropriateness Test.

See COBS 10.2.9 G (1) (a) – (l)

Appropriateness Test Coverage	Example Questions and Answers for Customers
a) the nature of the client’s contractual relationships with the borrower and the firm; k) the role of the firm and the scope of its services, including what the firm does and does not do on behalf of lenders;	What is your investment and how does [P2P Platform] manage it? Select all that apply. <ul style="list-style-type: none"> • By investing in [P2P Platform] your money will be matched with loans to borrowers. This means that credit agreements will be formed between you (as the Lender) and borrowers who will commit to repay you. • [P2P Platform] will manage your investment from start to finish. It will credit-check the applications, price the loans, match your money and collect the repayments when they are due to you. • [P2P Platform] will provide you with a tax statement every year, but it’s your responsibility to check if you owe anything to HMRC.
b) the client’s exposure to the credit risk of the borrower; c) that all capital invested in a P2P agreement or P2P portfolio is at risk; d) that P2P agreements or P2P portfolios are not covered by FSCS; f) that entering into a P2P agreement or investing in a P2P portfolio is not comparable to depositing money in a savings account;	Is peer-to-peer investing like depositing money in a savings account? Select all that apply. <ul style="list-style-type: none"> • Your money is being lent to borrowers and there is a risk that they will not repay. This is different to depositing money with a bank because your money is not guaranteed. • It’s the job of [P2P Platform] to manage and collect the repayments to your investment, but you are not covered by the Financial Services Compensation Scheme (FSCS). • An investment in [P2P Platform] is similar to saving in a bank account. It’s guaranteed by the FSCS so there is no risk.
e) that returns may vary over time;	Could the interest rate and your earnings be different to the rate advertised? Select all that apply. <ul style="list-style-type: none"> • The advertised interest rate shows what you are expected to earn at the time of your investment. Over

	<p>time you may earn a different rate as your money is repaid and reinvested into new loans.</p> <ul style="list-style-type: none"> • Your overall rate may also be reduced if your borrowers don't repay. • The interest rate is guaranteed because [P2P Platform] has a good track record.
<p>g) the characteristics of any:</p> <ol style="list-style-type: none"> security interest, insurance or guarantee taken in relation to the P2P agreements or P2P portfolio; or risk diversification facilitated by the firm; or contingency fund offered by the firm; or any other risk mitigation measure adopted by the firm; <p>h) that any of the measures (such as those in (g)) adopted by the firm cannot guarantee that the client will not suffer a loss in relation to the capital invested;</p> <p>i) that where a firm has not adopted any risk mitigation measures (such as those in (g)), the extent of any capital losses is likely to be greater than if risk mitigation measures were adopted by the firm;</p>	<p>What does [P2P Platform] do to reduce the risk to your investment?</p> <ul style="list-style-type: none"> • [P2P Platform] secures the loans on assets of the that may be recovered and sold if the borrower fails to repay. This is designed to ensure that your investment performs, but it's not a guarantee. • [OR] [P2P Platform] has a contingency fund which will automatically step in to repay you if the borrower fails to do so. This is designed to ensure that your investment performs, but it's not a guarantee. • [OR] [P2P Platform] automatically spreads your investment across at least [x] loans on the platform so that the risk of your investment is spread across many borrowers. This is designed to ensure that your investment performs, but it's not a guarantee.
<p>j) illiquidity in the context of a P2P agreement or P2P portfolio, including the risk that the lender may be unable to exit a P2P agreement before maturity even where the firm operates a secondary market;</p>	<p>When can you withdraw your investment?</p> <ul style="list-style-type: none"> • Only when the loan is fully repaid • At any time • Potentially at any time, but only if there are other investors that are ready to take over your loans. Otherwise you will have to wait until the loan is repaid
<p>l) the risks to the management and administration of a P2P agreement or P2P portfolio in the event of the firm's becoming insolvent or otherwise failing.</p>	<p>What would happen to your investment if [P2P Platform] went out of business?</p> <ul style="list-style-type: none"> • You would lose the rights to your investment. • [P2P Platform]'s wind-down arrangements would be triggered. These arrangements are a guarantee that your earnings will be as you expected. • [P2P Platform]'s wind-down arrangements would be triggered. These arrangements are designed to ensure that your investment will continue to perform as expected, but they are not a guarantee.

12. FAQs for P2P Platforms

Q: Does Appropriateness mean that P2P Platform must assess the suitability of the investment for the particular customer?

A: No. Appropriate in this context means of a level of risk and complexity that the particular customer should be able to understand given their knowledge and experience.

Q: If a customer has a great deal of investment experience, can they avoid the Appropriateness Test?

A: The P2P Platform is required to determine if the customer has both the necessary experience and knowledge in respect of the P2P Products offered by the platform in order to understand the risks involved. General investment experience may not be sufficient.

Q: Why can't the P2P sector have one single Appropriateness Test?

A: There is a lot of differentiation and choice in the P2P sector. As a result, it cannot be assumed that knowledge and experience of some P2P loans and platforms will automatically be sufficient to understand the risks involved with other P2P Loans and Platforms.

Q: Should the customer complete an Appropriateness Test per Product or is one test for whole platform sufficient?

A: It is for the P2P Platform to determine. If the matters in COBS 10.2.9 apply differently per Product the P2P Platform should consider whether to apply an Appropriateness Test per Product. Refer to Section 8 of this guide for more information.

Q: Does the customer need to complete an Appropriateness Test as soon as they register?

A: It is for the P2P Platform to determine when to assess appropriateness, but, in any event, this must happen before the customer invests.

Q: Does the Appropriateness Test apply retroactively to customers who invested before 9th December 2019?

A: Potentially, if they invest again. Refer to Section 7 of this guide for more information.

Q: Do I need an Appropriateness Test for all of my new customers?

A: Yes, unless they invest via an authorised or regulated adviser and suitability has been assessed.

Q: Do direct investors who self-certify as sophisticated or High Net Worth still need to complete the Appropriateness Test?

A: Yes

Q: Can a customer proceed to invest if they fail the Appropriateness Test?

A: It is for the P2P Platform to determine. Refer to Section 9 of this guide for more information.