leading on investments and savings

TISAtalk **1st April 2015**

NOW YOU SEE IT, NOW YOU DON'T

There is much excitement and discussion in the world of investments around the subject of crowd funding or peer to peer (P2P) lending. The institutions taking a lead here are invariably websites which allow people looking to raise finance, to post details of their project asking for backing. Investors can contribute as little as £10 and are typically offered shares in the business or other incentives in return. The dilemma for consumers and the regulator is that some websites vet the fundraisers, but others do not.

Some projects qualify for special tax reliefs under the Enterprise Investment Scheme or Seed Enterprise Investment Scheme rules. Here, investors qualify for generous tax breaks, such as being able to claim back income tax on the money they invest. However, investors' money is not protected by the Financial Services Compensation Scheme (FSCS). If the venture fails or never goes ahead investors stand to lose all their capital.

P2P vendors match firms or individuals who want to borrow money with savers or investors willing to lend. Borrowers can get a lower interest rate than is available through the banks and savers stand to make a better return on their cash. This aspect (P2P) is now regulated, however, again investors' money is not protected by FSCS and the total amount invested can be lost. The government is expected to allow P2P lending within ISA's for the first time this year to allow small businesses better access to credit. It is also considering whether to allow crowd funded debt-based securities into an ISA. These securities, which would resemble bonds, would be able to be bought and sold by investors.

Investors need to be aware that due to a process known as 'pivoting', where entrepreneurs seeking funding are able to raise cash from investors and then completely change their business plan without investors' approval. It could be that some do so for good reasons, however, in what is a largely unregulated sector, there remains a danger that entrepreneurs will raise money from trusting investors for one stated project and then radically change their venture or even disappear with the money. This will be a concern for those investors who are frustrated with high street banks current savings rates and are attracted by the potential for higher returns from these ventures.

In this world, there are still risks to investing in start-ups and indeed even a recent venture by the respected Nicola Horlick had a change of direction without investors being aware. The original plan was to create an upmarket brasserie in Chiswick. The original deal did not materialise and investors' money was then used for a different venture. The underlying principle consumers must understand here is that when buying shares in a company via a crowd funding or P2P website, they may assume they have some ownership but in reality they have no control over the project at all. If this sector attracts further regulation, which is likely, it will be interesting to see how the FCA and Treasury ensure suitable consumer outcomes are achieved, as required under current rules.

In addition, while the platforms themselves are regulated the fundraisers aren't. There will always be the risk therefore that ventures may never launch or could fail and incentives may never materialise. There is also no recourse to the FSCS, which protect savings and investments in the regulated market to an upper limit of £85,000 and £50,000 respectively per firm. The FCA has introduced rules requiring investors to confirm they are not investing more than 10% of their assets, excluding property and pensions, but the limit does not apply to those who class themselves as experienced crowd funding investors. It will be interesting to see how ISAs develop in this new universe.

Peter Smith, Head of Policy Strategy Development