Post-implementation Review of Crowdfunding Rules

Response by TISA to FCA Call for Input

8 September 2016

About TISA

TISA is a not-for-profit membership association operating within the financial services industry. The focus of our recommendations and actions is improved outcomes for consumers and UK plc with this approach leading to a stronger UK financial services industry.

TISA's growing membership comprises over 150 firms involved in the supply and distribution of savings and investment products and services. These members represent many different sectors of the financial services industry, including asset managers, insurance companies, fund managers, distributors, building societies, investment managers, third party administrators, consultants and advisers, software providers, financial advisers, pension providers, banks and stockbrokers.

TISA has a successful track record in working cooperatively with government, regulators, HMT, DWP and HMRC to improve the performance of the industry and the outcomes for the public. Effective policy and regulation and the creation of efficient industry infrastructure continues to be the major focus for our members. TISA is unique in that it represents the entire financial services industry, incorporating cross-sector policy, industry and technical expertise. Whilst we maintain a solid partnership with government, the regulators and wider industry, we remain independent and develop neutral views and opinions. This impartiality is reflected in our ability to drive development projects, which improve industry performance and consumer outcomes, putting us in the unique position of being able to constantly challenge the status quo to bring about material improvement.

Post-implementation Review of Crowdfunding Rules

Summary of Recommendations

TISA welcomes the post-implementation review and wishes to support and engage with the FCA to improve regulation of crowdfunding platforms. We wish to see sensible and proportionate regulation that encourages innovation, competition and growth whilst appropriately protecting investors.

We would also urge the FCA to consider which areas of the regime can be improved to improve competitiveness in an industry that is seen as Europe's leading market for alternative finance providers.

We would also urge the FCA to consider how it will regulate and support the industry as it develops further as new participants enter the sector, including the diverse TISA membership which includes major financial institutions, as well as new consumer groups such as advised investors. A satisfactory, robust, forward looking and prompt conclusion to the post-implementation review process will assist in bringing further clarity and confidence in the sector to the benefit of investors, consumers and businesses seeking finance and participants.

In this context we should say that we are very disappointed that so few firms have been approved after all this time. We consider that the FCA is acting anti-competitively, placing disproportionate regulation on this new and growing industry. We agree that the FCA should properly assess applications, but if they take so long and so few are approved this indicates a lack of resource at the FCA. Inhibiting access to the market is bad for competition, expensive to firms and bad for investors.

Q1: Do you consider that there is the potential for regulatory arbitrage with banking business? If so, what measures should be considered to address it?

A: We believe that loan-based crowdfunding is inherently different to banking, so whilst we do consider there to be a potential for regulatory arbitrage based upon some current industry practices (mis-matching lending commitments with loans), this potential is reduced if the current regulation is enforced robustly. We do not see evidence of banks entering into the loan-based crowdfunding space but plenty of evidence of new banks entering the banking business. This implies the banks themselves do not see them as a regulatory opportunity.

We also do not consider there to be a significant risk of regulatory arbitrage between the asset management sector and loan based crowdfunding platforms. The latter are subject to the Handbook covering specific client money, prudential requirements as well as financial promotion, corporate governance, and living wills rules that have been tailored for the industry and have been carefully considered and we feel are appropriate and fit for purpose balancing consumer protection, current and emerging risks and competition.

Q2: Do you have any concerns about, or evidence of, differences in the treatment between retail and institutional investors?

A: Anecdotally, we have seen some evidence of differential treatment. Whilst we have also seen evidence of platforms demonstrating extensive consideration of the TCF implications of accepting institutional funding, we do think this should be addressed and guidance (on both acceptable practice and disclosure to consumers) enhanced. We believe that differential treatment, commercial terms aside, are likely to breach TCF. We would expect larger investments to get better terms on fees, returns, etc.

Q3: Have you seen any initial evidence that the ISA wrapper has led to consumers not fully appreciating the risks involved in Innovative Finance ISA investments?

A: We have seen no evidence to date.

Q4: Are there differences in borrower protection between commercial and non-commercial agreements that would be best addressed by applying additional rules to P2P platforms, or are the existing rules adequate?

A: We have not seen evidence of borrowers under non-commercial agreements being disadvantaged by the fact that certain sections (76, 77, 77A, 78, 87 and 98) of the Consumer Credit Act applicable to lenders acting by way of business, do not apply. However, this does not detract from the fact that there should be a consistency of approach and these provisions should either be applied or disapplied consistently, regardless of the identity of the lender.

We do not see the logic in applying different standards of borrower protection by reference to the identity of the lender where there is a regulated intermediary responsible for promoting and enforcing the terms under the loan agreement. There should be a single regime for borrower protection. Where the lender is exempt from regulation on the basis of the status of the borrower (for example, lending more than £25,000 to sole traders), the fact that credit brokers and P2P platforms need to provide the borrower with protections creates untold complexity without a regulatory justification that is apparent to us. Similarly, if a lender would need to provide borrower protections but for the fact they are not operating by way of business, the P2P platform should have to provide those protections uniformly: the identity of the lender is not important to the borrower when they are dealing through a P2P platform, so it should not affect the protections they receive one way or the other. Equally, it should not affect the need for lenders using the platform to be regulated: the platform operator (or any delegate enforcing the terms of loan agreements) should be the only party subject to regulatory obligations.

Ultimately, the confusion in the current system emanates from article 36A(4) of the Regulated Activities Order, which expands the scope of consumer credit related activities beyond regulated credit agreements. The article 36H(6) definition of a borrower could be interpreted as an attempt to exclude from regulation syndicated lending by exclusively corporate lenders to borrowers who would fall within article 60C. However, its application by the FCA results in the mixing of regulatory regimes by reference to the composition of lenders and the individual amounts they lend which is confusing to both users and operators of P2P platforms. The perimeter of regulation is arbitrary and being applied with a rules based mindset rather than the exercise of intelligent regulatory discretion.

We recommend that the FCA's current approach and the underlying rules be substantially re-worked to ensure that:

1. borrower protection is determined by reference to their total borrowing;
2. the identity of the lender does not determine the protections the borrower receives;
3. borrower protection is the same across all loans arranged in a series of connected transactions; and
4. the lenders are not subject to regulation in respect of lending through a platform (NB: article 36H requires the platform operator to undertake to enforce the terms of the loan agreements).

Q5: Do you agree with our analysis of the key developments in the loan-based crowdfunding sector over the last two years?

A: The presentation of the question indicates that the key developments are limited to the possibility of residential mortgages being offered through P2P platforms, although we assume the question relates to developments noted throughout the paper. We consider that most of the developments occurred over two years ago and were present in the models when article 36H was drafted. For example, provision funds, institutional investments and autobid arrangements existed when the legislation and Handbook rules were drafted.

In respect of home finance lending, we believe the same principles set out in our response to Q4 should apply and, in particular, regulatory obligations should fall exclusively on the platform operator and should be applied regardless of the identity of the lenders.

Q6: Are you aware of current or emerging risks that firms' current infrastructure, systems and controls might not be adequate to deal with?

A: We are not aware of any more risk than any other growing area of the market.

Q7: Do you have any comments on our concerns over the development of new loan-based crowdfunding business models? Have there been other specific developments that are relevant to the high-level standards summarised above?

A: We would be very happy to discuss this in more detail with the FCA. We believe that any extension of the asset management sector requirements for collective investment funds for application to crowdfunding should be considered in the light of any post-Brexit regulatory regime.

Any extension of regulation, with its cost and impact on customers and businesses, should be proportionate to the potential customer detriment.

At a high level, we would emphasise that the aim of the P2P regulation was to enable retail money to diversify into new forms of investment at scale with proportionate regulation to ensure consumer protection. Prior to the launch of P2P and crowdfunding, choice and diversification for retail investors was limited to highly correlated assets traded on public markets.

We are concerned that the current regime and its enforcement and interpretation by the FCA, while simple in some ways, is unnecessarily complex in others and causes confusion for the platforms and the FCA. This creates uncertainty for both existing and potential new industry participants (thereby impacting competition and choice) as well as confusion for consumers. We also believe that innovation in the industry that enables economies of scale and increased investor choice should not automatically be greeted with concern and a need for more regulation, when applying existing rules and principles in new ways is more straightforward.

We believe that investors do understand the benefits of diversification of risk and are able to make their own decisions in that regard both within individual platforms and across the market. The behaviour of investors does not reflect the belief that individuals are not aware of the benefits of proper diversification.

Q8: Do you have any comments on the standards of disclosure on loan-based crowdfunding platforms?

A: We note that FCA authorised loan-based crowdfunding platforms are subject to existing FCA rules governing disclosure standards (including, where relevant, COBS 10), and does include an overarching high level principle obligation to ensure that all information provided to investors and potential investors is clear, fair and not misleading. We agree with the FCA's approach in its Policy Statement 14/4 (published on 6 March 2014) ("PS 14/4"), on its regulatory approach to crowdfunding over the internet, which sets out that the FCA considers different offers to involve different risks. We concur that differing activities of different platforms will be subject to levels of disclosure as is appropriate to the activities being undertaken by each platform.

We support appropriate disclosure of risks to customers, and would support clarity to support standardisation of disclosure, performance and platform data, so that customers (investors) know what they are getting and can understand the risks. We welcome the opportunity to discuss how the disclosure regime would work in a proportionate, sensible way for customers and the industry. Also, we note that the FCA has specifically welcomed the industry's efforts to police its own sector.

Q9: Are our current financial promotion rules for loan-based crowdfunding promotions proportionate? If not, can you please provide examples?

A: We are supportive that the FCA's financial promotion rules should apply to loan-based crowdfunding platforms as for other FCA authorised entities. This is notwithstanding the case that, as the FCA's Call for input states, the 2015 UK Alternative Finance Industry Report indicated that 21% of P2P platforms surveyed think that the FCA's approach to online and social media promotion is 'excessive and too strict' for their platforms' activities.

We believe that it is important for the integrity of the financial promotion regime and the loan-based crowdfunding industry that a separate exemption or differing treatment is not created for loan-based online crowdfunding platforms.

We believe that the FCA should, however, take a greater role in educating online peer-to-peer platforms about its financial promotion regime. Many firms will be new to the area of financial regulation and we think that the FCA should take a more proactive role in the education of such FinTech firms about how the financial promotion regime works and its importance in helping ensure that customers are given clear, fair and not misleading information before they invest.

We would be happy to discuss with the FCA ways in which we could help with regards to the appropriate dissemination of information required to new and existing participants in the industry as may be required.

Q10: Is our approach to online and social media promotions proportionate? Do you have any suggestions as to how to improve our rules or approach on promotions?

A: We are broadly in agreement with the FCA's approach stated in its Finalised Guidance 15/4 (published on 13 March 2015). We believe that it is important that FCA authorised loan-based crowdfunding firms understand the broad nature of possible recipients of any financial promotion made via online and social media, including the concept that certain communications may end up in front of a non-intended recipient (for example, via the form of a retweet on Twitter or a 'share' on Facebook) and consequently all communications must be clear, fair and not misleading at the outset.

Nonetheless, we would encourage the FCA to continue to develop further guidance on the use of online and social media for authorised firms and perhaps to produce guidance which is specifically directed at loan based crowdfunding firms to ensure that the application and understanding of the FCA rules to this sector are fully understood and available to newer participants in this growing sector.

Q11: Should we require loan-based crowdfunding platforms to assess investor knowledge or experience of the risks involved? What would a proportionate requirement look like?

A: We are of the view that the current position in respect of assessing investor knowledge and experience is appropriate and do not see a need to extend the application of COBS 9 to loan based crowdfunding platforms at this time. This is not least because most platforms themselves do not provide personal recommendations to potential investors or investors but rather hold the function of a facilitator as opposed to providing 'advice'.

We believe that it is reasonable that if a platform provides a MiFID service, that platform should be subject to the COBS 10 rules on appropriateness, as is currently the case.

TISA has recently published its Approach to Implementation of Appropriateness for MiFID II. As FCA knows, an appropriateness assessment is not required for UCITS, and may be required for other securities or funds such as AIFS, or NURS. We do not believe that loan based crowdfunding is inherently more complex than many UCITS; so do not believe that an appropriateness assessment should be required as a default.

A copy of our guide is attached with this response.

In instances where a platform would be providing a personal recommendation and the suitability requirements would 'kick-in', we would be of the view that it would be useful for the FCA to produce further specific guidance on how they expect those platforms to comply. We would be delighted to discuss in further detail what this may entail with the FCA at a future date.

Q12: What effect do you think loan based crowdfunding has had on competition in lending and investment/savings markets?

A: We believe that the growth of the markets indicates a pent-up demand from customers and businesses, which should be welcomed. Investors have been able to access better returns and borrowers, whether individuals of corporate, have been able to borrow more efficiently.

Loan based crowdfunding has driven competition in multiple loan classes and fills funding gaps where banks have withdrawn thereby providing much needed funding for certain sections of the UK economy (typically property). The Nesta report quoted by the FCA in this call for input highlights the positive impact loan-based crowdfunding has had on the access to finance.

Loan based crowdfunding platforms are often quoted as providing improved pricing and customer experience to borrowers and so they have had a positive impact on the lending market.

As an investment product, loan-based crowdfunding has had a positive impact upon the retail investors ability to generate interest income in a period of low interest rates and therefore have been an important source of returns for investors in the sector.

However, the ability of loan based crowdfunding to compete as an investment product has been hampered by a lack of clarity in the development and application of regulation. This has undermined confidence in loan-based crowdfunding amongst existing investors and amongst professional investment advisers. It is noted that elsewhere within this Call for Input the appropriateness of loan-based crowdfunding is questioned, however unless there is a clear tone from the top as to how to deal with the sector, the ability for loan-based crowdfunding to compete with traditional investment products will be limited.

Q13: Where do you think regulations could be amended to increase confidence in loan based crowdfunding markets, encourage the development of the markets in the interest of consumers or increase competition by removing uneven playing fields?

A: There is a mis-match in the regulation around the distribution of loan based crowdfunding;

- retail investors do not need to undertake an appropriateness test to invest when investing directly,
- loans will be eligible for inclusion within the ISA in due course,
- professional investment advisers have permissions to advise on P2P (incidentally not classified consistently as loan-based crowdfunding) as a regulated activity,
- loans themselves are unregulated products,
- loans are classified as non-mainstream retail products,
- the asset class does not have sufficient stochastic modelling to support traditional or widely adopted suitability analysis,
- loans are treated as non-standard assets for SIPPs.

Bringing these points together, the environment is therefore a difficult one for platforms, aggregators/intermediaries and professional investment advisers to navigate in order to provide advice around the appropriateness and suitability of loan-based crowdfunding products to new and underserved investor segments. We would note anecdotal evidence of an increase in appetite for loan-based crowdfunding products amongst the intermediary sector, especially in light of further reduced bank rates. The FCA has questioned whether loan based crowdfunding is suitable for all investors yet there are limited tools and channels within which to improve customer outcomes.

We would welcome additional guidance or clarification from the FCA as to the treatment of loan based crowdfunding products in order to ensure that there is greater clarity. This would increase confidence amongst all stakeholders within the sector, including financial advisers and consumers, that loan-based crowdfunding is in reality an appropriately regulated product and sector and should be seen as a valuable asset within an investor's individual portfolio. We believe that such clarification or guidance support would assist in leading to improved customer outcomes, more capital for loan based crowdfunding platforms and increasing the range of product options available by the sector to potential investors.

Q14: Do you have any comments on the resolution plans of firms operating loan based crowdfunding platforms?

A: We believe that it is a matter for businesses with their auditors to ensure resolution plans are appropriate and we would expect internal auditors of such businesses to raise any issues in their reports to risk committees. We would welcome the opportunity to discuss the issue further with the FCA.

Q15: Are there any other matters we should take into account in the post-implementation review of loan based crowdfunding?

A: We are concerned that the approach from the FCA is not in line with the stated objective of wanting to support competition and innovation created by the loan-based investment sector.

It has been disheartening to watch the authorisation process. We understand the need for the FCA to properly vet applicants, but it must take a proportionate view and remember that it can continue to assess firms once they have been authorised. It appears that policy and supervisory work is being done throughout the process whilst firms are held back from conducting any business or being able to launch.

This is a diverse marketplace and it may not be possible to create a prescriptive, one size fits all answer we worry that if the FCA focuses on rules rather than principles there is a chance that it will simply create loopholes and unintended consequences.

The industry would oppose access to the FSCS as it would mislead investors into thinking they had some form of deposit guarantee.

Q16: What other market developments should we take into account in our review of the investment-based crowdfunding sector?

A: A broader range of asset classes is now available on crowdfunding platforms, and we expect platforms to operate under financial promotion and appropriateness rules that are fitting for the investment in question. The regime for investment-based crowdfunding uses the same rules applicable to many offline businesses, such as corporate finance houses for example, and as a result, it is easier to identify the applicable rules for new products and services than it is under the rules for loan-based platforms which are bespoke to that industry.

There is a diversity of offerings for consumers across the investment-based crowdfunding platforms.

This is a fantastic step towards providing consumer choice. It didn't seem from the comments within the Call for Input document that this diversity was yet reflected in the FCA's thinking. There were a number of sweeping statements made within the investment-based chapter of your document which has caused concern and which we will tackle below.

The FCA's assertions on complaints or not understanding the risks of investment are not reflected in the facts on the ground. For example, we are aware of single digit numbers of complaints going to the Financial Ombudsman and none of these complaints to date being upheld. We would encourage the regulator to access the data which the industry holds and is willing to share, to evidence such claims in the future.

Q17: Do you have any comments on the management of conflicts of interest on investment-based crowdfunding platforms?

A: For many years the FCA has encouraged platforms to also treat investors as clients, rather than, say, corporate finance contacts. This creates a potential conflict of interests, and presumably at the time the protections that came from investors being treated as clients outweighed this.

By way of example, you identified that some firms may be under pressure to put a larger volume of deals through the platform and this could lead to lower standards of due diligence than investors would expect. While any such conflict should certainly be considered, we would also highlight that this is a diverse marketplace with many different business models available to consumers. Highly curated platforms exist alongside platforms that have a wider offering and allow investors to choose what is of interest to them. As long as conflicts are managed in both models, and as long as there is transparency about the mechanism of the platform, including how much due diligence has been done, consumers should be allowed to choose their preferred model.

Overall the existence and management of conflicts will look different from platform to platform. We consider that, in addition to firms being subject to Principle 6 and TCF, the rules around disclosure, financial promotions and appropriateness mean that investors understand the business model of the platform they are using.

This is an area where guidance from the FCA would be very welcome.

Q18: Do you have any comments on current due diligence standards for investment-based crowdfunding platforms?

A: Beyond having the right disclosures in place specifying the extent of platform due diligence and the risks to investors, this isn't a matter for regulation. It's for the market to decide what they want.

We would support formalized guidance from the FCA.

Q19: What do you think of the current client assessment standards on investment-based crowdfunding platforms?

A: When the existing standards are applied properly, good customer outcomes are obtained.

It was never intended that the self-certification process which investors go through should be policed by platforms, rather an appropriateness test would act as the key protection mechanism. These tests in our opinion remain a far more meaningful safeguard against people investing without understanding the consequences.

As you can imagine, there would be a practical difficulty for platforms in ensuring that investors really do meet the criteria of a restricted, high net worth or sophisticated investor statements, but more to the point, those certifications in themselves are not the most meaningful of controls.

In terms of appropriateness, crowdfunding platforms have some of the best mechanisms in the financial services industry to prove that informed decisions are being reached rather than just asking someone to select a number of investments they have made previously. For example, platforms create real-time tests in which investors need to demonstrate that they understand the risks that are relevant to the investments on that platform.

Q20: What do you think of the current standards of information disclosure on investment-based crowdfunding platforms?

A: The rules about levels of disclosure create the right outcomes for consumers and as an association, we place considerable emphasis on the need for informed decision making and transparency. Between disclosure, financial promotions rules and the appropriateness tests, we believe that customers understand what they are investing in. If the FCA receives evidence to the contrary, we would welcome the opportunity to see this as, at present, we have no basis on which to be concerned about disclosure.

Q21: Should we mandate the disclosure of risk warnings in relation to non-readily realisable securities held within Innovative Finance ISAs?

A: As mentioned above, we are happy with the concept of asking platforms to disclose the risk of their products and see no reason why this should not be rolled out to securities sold within the IFISA wrapper. However, if risk disclosures are to be required in some form or other, we would welcome that such disclosure should also be rolled out to the stocks and shares ISA. That way, risk disclosure becomes a part of the overall ISA process.

Q22: Are there any other matters we should take into account in the post-implementation review for investment-based crowdfunding?

A: Overall, the regime for investment-based crowdfunding has worked well. Investment-based platforms have been on all fours with their offline counterparts such as corporate finance houses, fund managers and custodians, which has made for a clear regime. There are areas where the offline rules simply do not work, such as social media, and we would welcome review of these.