FINANCIAL CONDUCT AUTHORITY

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Lord Myners
House of Lords
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Dear Paul

RE: Lendy Ltd

Thank you for the questions that you have posed to Her Majesty's Government in relation to Lendy Ltd. The Treasury have passed a number of these to the Financial Conduct Authority (FCA) to answer and responses to each question will be laid in the House of Lords Library in due course. However, in view of your questions, the recent release of the Joint Administrators' report and ongoing public interest in the matter, I thought it would be appropriate to provide as much information as I can in a letter that will also be published on the FCA website.

P2P firms

Lendy was incorporated in 2012 and was already operating as a peer-to peer (P2P) firm facilitating investment in loans when the FCA began regulating the sector from 1 April 2014.

P2P firms facilitate lenders making loans directly to borrowers through a platform. A P2P loan is a form of investment, rather than a savings product. It generally offers a significant premium on the interest income which might be obtained from savings in a deposit in a bank or other deposit taking institution. This higher return reflects in large part that this investment is generally considerably riskier – for instance, if the loan is to fund speculative property development. Furthermore, unlike a deposit, which is like a loan to a bank, the investment does not usually benefit from FSCS protection.

For a firm to be authorised to operate a P2P platform, the operator needs to facilitate P2P agreements that are compliant with article 36H of the Regulated Activities Order, and the platform needs to meet the Threshold Conditions. Loans are facilitated between lenders and borrowers by P2P firms, but these firms cannot directly invest in the loans themselves. However, during the administration process of Lendy the administrators have found that Lendy had a back book of 4 loans that appear not to be P2P agreements.

Authorisation of Lendy Ltd

As outlined above, when Lendy became regulated by the FCA under an Interim Permission on 1 April 2014 it was already facilitating investment in loans. The firm made an application to become fully authorised on 30 March 2016. The FCA is required to make a decision either to approve or refuse the applications we receive.

Prior to authorisation of the firm we were in close and continuous dialogue with it, providing feedback on their application and what they needed to do to protect the interests of consumers. Due to this dialogue, the firm put in place an action plan to address concerns we had relating to its governance and systems and controls. It also volunteered to complete a remediation exercise after we identified issues with the quality of information being presented to investors on certain loans. An independent third party had been engaged to consider the full loan book in light of our initial concerns. The remediation exercise was based on this assessment and was on track at the point of authorisation.

The authorisation assessment of Lendy considered it against all the Threshold Conditions. At the time of authorisation, which took into account the improvements Lendy had made, the firm provided information to the FCA such that it could demonstrate that it met the Threshold Conditions, including financial resources. As P2P firms cannot invest in the loans themselves they do not directly bear the credit risk when a loan defaults. This generally means that their financial position is not as severely affected by non-performing loans as a traditional lender. In Lendy's case, its revenues included a mix of upfront fees, loan exit fees, fees from loan recoveries and an interest rate margin on loans. This mix of revenue sources meant that Lendy's financial position should have had some resilience in the event of increased arrears and/or defaults.

At authorisation, the agreed focus was on loan recoveries and embedding a new governance structure and management team, with input from third party professionals and advisors. In addition, although not formally closed to new business upon authorisation, no new development loans were offered reducing its ability to expand the business. However, additional tranches of existing development loans were available due to the potential impact on investors of such tranches not being filled and the performing loans were available for trading on the secondary market. The level of new investment, and re-investment, was very low.

If we had taken the decision to not authorise there was a risk that the FCA would not be able to ensure the remediation plan progressed as planned, and there was an additional question over whether any redress could have been made if the firm was unable to trade. This could have led to increased consumer harm.

Following the firm's authorisation on 11 July 2018, the FCA remained in close and constant dialogue with the firm, including on the status of their loan book.

Our supervisory activity

We became concerned about new information received and actions taken by the firm post-authorisation. This included a charge being taken over the Provision Fund, slow progress in improving controls, a request to extend the deadline for completion of the remediation exercise and slow progress on recoveries. This led us to require the firm in November 2018 to notify us after making most types of payments of over £5,000. We did so to protect investors and maintain oversight of the firm's assets. We also continued to meet and speak with the firm on regular basis. Then, concerned about continued slow progress on recoveries and the departure of newly-appointed members of two new management teams in quick succession, we placed the firm on our Watchlist in January 2019. This placed Lendy under even greater scrutiny, including a requirement to report its status to us on a weekly basis.

We received new intelligence in April 2019 that led us to undertake short-notice visits to the firm which further diminished our confidence in the firm's ability to manage its own affairs. Following these visits, we immediately placed an asset restriction on the firm to reduce harm to investors, removing the firm's access to its bank accounts and requiring all payments to be authorised by the FCA.

Further concerns about the firm's conduct and true financial position led us to advise the firm on 22 May that we had petitioned the court to seek the appointment of provisional liquidators. The provisional liquidators would have been able to assess the position of the firm and help determine the true solvency position of the firm and best course of action for protecting investors. The director of the firm subsequently requested that the firm be placed in administration. We consented to this as we believe this is the best means of returning money to investors.

Turning to some of the specific questions that you have posed, I would note that the Administrators of Lendy are currently considering the exact legal status of investors based on their contractual positions, and that this will likely determine whether or not they are creditors of Lendy. The FCA had previously identified that retail lenders' investments, and the loans facilitated on the Lendy platform, were showing on Lendy Ltd's balance sheet. After discussion with the firm's auditors, it was proposed that these corresponding investments and loans would be removed from the firm's accounts for the period ended 31 December 2018, with the comparative position in the 2017 accounts being restated accordingly.

The firm's accounts for the year ending 31 December 2018 had not been filed at the point the firm entered administration, and the accounts for the year ending 31 December 2017 have not been restated. Therefore those filed still show the loans and investments on balance sheet.

Our rules for P2P firms

As we noted in our press release of 4 June 2019, when the FCA set its first rules for P2P we committed to keep these under review as the sector evolved. Over the last few years, P2P investors have been attracted by the potential to receive returns significantly in excess of those available through other investment types. Following consultation with industry stakeholders, the new rules we introduced in June 2019 are designed to help better protect investors and allow firms and fundraisers to operate in a long-term, sustainable manner. This includes a greater emphasis on risk management and pricing and, importantly, its related disclosure. Our supervisory work will also continue to consider the relative risks and returns offered by P2P platforms. The experience of the senior managers of any firm, including a P2P firm, is considered as part of our authorisation process, and also assessed as part of the subsequent supervision of that firm.

We are carrying out an Enforcement investigation into the circumstances that led to the administration of Lendy, and it would therefore be inappropriate to comment further on those matters under investigation. Our primary focus remains the protection of investors, but I can confirm that the FCA will not be compensating lenders for any shortfall in the firm's remediation plan.

I hope that this is helpful.

Andrew Bailey

Andrew Bailey
Chief Executive