

## Regulator Assessment: Qualifying Regulatory Provisions

**Title of proposal:** PS 16/8: FCA Handbook changes regarding the segregation of client money on loan-based crowdfunding platforms, the Innovative Finance ISA (IFISA), and the regulated activity of advising on peer-to-peer (P2P) agreements<sup>1</sup>.

**Lead regulator:** FCA

**Date of assessment:** 29/07/2016

**Commencement date:** 21 March 2016: rules regarding the segregation of client money on loan-based crowdfunding platforms

6 April 2016: rules regarding the IFISA and the regulated activity of advising on peer-to-peer (P2P) agreements

**Origin:** Domestic (Changes to Secondary legislation by UK Government impacting on the market- IFISA)

CASS – Changes at FCA initiative

**Does this include implementation of a Cutting Red Tape review?** No

**Which areas of the UK will be affected?** Authorised firms undertaking relevant regulated loan-based crowdfunding activities in the UK

### Brief outline of proposed new or amended regulatory activity

Background

Our proposals in CP16/2 and CP16/5 align the regulatory framework with the following changes to UK legislation:

- HMRC amending the ISA Regulations<sup>2</sup> to allow Peer to Peer (P2P) agreements to be held within an ISA wrapper (the Innovative Finance ISA or IFISA). The IFISA became available on 6 April 2016.
- HMT amending the Regulated Activities Order (RAO) to make advising on P2P agreements a regulated activity. (This was inserted into A53(2) of the RAO.)

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<sup>1</sup> This PS brought together two separate CP's; segregation of client monies (CP 16/4) and Handbook changes as a result of Introduction of IFISA et al (CP 16/5).

<sup>2</sup> Individual Savings Accounts Regulations 1998

## **New requirements**

### Client money

CP16/4 consulted on the following:

1. rule changes to explicitly allow firms that hold money in relation to both peer-to-peer and business-to-business agreements<sup>3</sup> to be able to elect to hold all lenders' monies under our client money rules<sup>4</sup> (in CASS 7) if they wish to do so.
2. New guidance to clarify that, where a firm holds money that has not yet been invested for a client, this should be client money held under the CASS rules, unless the circumstances are such that it could never be money held in relation to a P2P agreement.

### Advice on investment in p2p credit agreements

In CP16/5 we consulted on the following:

- guidance on existing disclosure rules to clarify what information firms should disclose in relation to IFISAs
- rule changes to apply our rules on suitability to firms making personal recommendations<sup>5</sup> in relation to P2P agreements
- rule changes to apply our rules that ban the payment or receipt of commission by firms in relation to personal recommendations involving advice on P2P agreements
- rule changes to ensure that financial advisers who advise on P2P agreements are appropriately supervised and assessed as competent to carry out that activity (including attaining an appropriate qualification), and
- rule changes to ensure that our rules provide consumers, who receive advice on P2P agreements, with access to the Financial Ombudsman Service (ombudsman service) and Financial Services Compensation Scheme (FSCS)

These changes extend obligations that advisors already had in relation to advising on other regulated investment products to any advice they might provide on loan-based crowdfunding investments or P2P loans qualifying for inclusion in the IFISA.

## **Which type of business will be affected? How many are estimated to be affected?**

Type of businesses affected by changes (estimated impact in brackets):

- Firms operating loan-based crowdfunding platforms (25 currently fully authorised, another 54 currently seeking authorisation; we assume an eventual population of ca 90 firms)
- Firms that are managing IFISA's (currently 7<sup>6</sup> but eventually up to c. 79 firms<sup>7</sup>)

Financial Advisers (only 9%<sup>8</sup> of the total population of c. 15,500<sup>9</sup> advisers, or ca. 1,400 advisers, expect to consider loan based crowdfunding in their advice; however most of those

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<sup>3</sup> To be a peer-to-peer agreement, a credit agreement must satisfy conditions set out in A36H of the RAO. It is possible for loan-based crowdfunding platforms to facilitate investment in A36H loans alongside investment in loans that do not satisfy the conditions set out in A36H (typically loans originated as agreements between institutional lenders and corporates).

<sup>4</sup> Firms holding money as 'client money' are subject to a range of obligations in our Client Assets (CASS) sourcebook, including but not limited to the segregation of client money from the firms' own funds and daily reconciliation of funds

<sup>5</sup> Broadly speaking these refer to the obligations that a firm providing regulated advice has to check that the products they are recommending are suitable for the client given their investment objectives, risk appetite etc.

<sup>6</sup> <http://www.p2pfinancenews.co.uk/2017/02/22/p2p-ifisa-tax-year/> Note also that another 23 are registered with HMRC as IFISA managers but do not have offerings in place.

<sup>7</sup> This is the population of p2p firms currently authorised or awaiting authorisation.

<sup>8</sup> <https://www.moneymarketing.co.uk/issues/17-december-2015/advisers-shun-p2p-and-crowdfunding-isa-changes/>

are unlikely to ever advise on this. See additional validating calculations at the end of this assessment)

Price base year	Implementation date	Duration of policy (years)	Business Net Present Value	Net cost to business (EANDCB)	BIT score
2016	2016	10	0	0	0

**Please set out the impact to business clearly with a breakdown of costs and benefits**

***Incremental costs as a result of introduction of IFISA tax wrapper (affecting P2P Platforms)***

Impact: Rules already existed prior to our proposals to require firms to provide clients with ‘a fair and prominent indication of any relevant risks’. Therefore the guidance introduced did not impose any additional cost requirements on firms: the guidance merely clarified the information we would expect should already be disclosed by firms. Therefore firms should not have suffered any additional cost as a result of this policy.

***Incremental costs for firms in relation to advising on P2P agreements (affecting Financial Advisers)***

Impact: Our call for input and subsequent survey of investors (see Footnote 8) revealed that this market was primarily non-advised and changes would be unlikely to take place rapidly to alter this position. Financial Advice firms indicated a reticence to start advising on P2P agreements due to difficulty in conducting due diligence (see also Footnote 6).

- Firms already in the financial advice market that wish<sup>10</sup> to provide regulated advice on P2P agreements, in addition to regulated investment advice they already provide, would already have systems and controls in place for investment advice which would require minimal adaption to accommodate P2P lending. **Incremental costs were therefore expected to be minimal.**
- **We considered opportunity costs to be minimal** on the basis that our consultation revealed no significant interest from new entrants looking to establish intermediary business models to provide advice specifically on P2P agreements. And previous survey evidence suggested that there was limited interest among financial advisers.<sup>11</sup> Furthermore, the ratio of prospective advisees to prospective advisers is very low, meaning that very few firms would be likely to advise on P2P agreements on a regular basis.<sup>12</sup>
- There may be modest incremental costs as a result of the redress and compensation arrangements required for those firms that give advice on P2P agreements, however future increases in redress payments are out of scope of this QRP assessment (Exclusion E).

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<sup>9</sup> Based on estimates from March 2016, supplied by Authorisations.

<sup>10</sup> For additional background, we did not, as a result of this Policy mandate that firms must consider P2P agreements under our RDR rules. Therefore, the option to provide investment advice on P2P agreements remains at the firm’s discretion.

<sup>11</sup> See footnote 8

<sup>12</sup> See our discussion of CCAF survey evidence in the “additional information” section.

**Incremental costs for firms in relation to CASS changes to allow P2P platforms the option to segregate client monies.**

Impact: We introduced a rule change to allow P2P platforms to hold money from unregulated lending under CASS alongside money from their regulated lending.

The change introduces flexibility in firms' management of client monies and is optional for firms. Hence there are no incremental costs. There are possible indirect benefits (cost reductions) which depend on behavioural responses to take up potential opportunities to achieve efficiency gains. We are not in a position to estimate these benefits which, being indirect, are out of the scope of this assessment.

**Please provide any additional information (if required) that may assist the RPC to validate the BIT Score.**