Financial Conduct Authority

Policy Statement PS14/4

The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media

Feedback to CP13/13 and final rules

March 2014

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In this Policy Statement we report on the main issues arising from Consultation Paper 13/13 *The FCA's regulatory approach to crowdfunding (and similar activities)* and publish the final rules.

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Abbreviations used in this paper

CBA	Cost benefit analysis
CMAR	Client Money and Asset Return
CP	Consultation Paper
DMD	Distance Marketing Directive
FCA	Financial Conduct Authority
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act
IFA	Independent Financial Adviser
MiFID	Markets in Financial Instruments Directive
OFT	Office of Fair Trading
PD	Prospectus Directive
PRA	Prudential Regulation Authority
PS	Policy Statement
RAO	Regulated Activities Order
UCIS	Unregulated collective investment scheme
WACC	Weighted average cost of capital

1. Overview

Introduction

1.1 In October 2013, we published a consultation paper (CP) detailing our proposed approach to the regulation of firms operating online crowdfunding platforms or conducting other similar activities.[1] In this policy statement (PS) we summarise the feedback to the CP, and give our response to this feedback.[2] We also publish rules that will come into force on 1 April 2014.

Who does this affect?

1.2 This paper will be relevant to consumers and consumer organisations with an interest in the investments offered on crowdfunding platforms, and similar investment offers such as the marketing of mini-bonds.

1.3 This paper applies to:

- Firms that operate or plan to operate peer-to-peer lending platforms or peer-to-business lending platforms (which we refer to as loan-based crowdfunding platforms in this paper) on which consumers can invest in loan agreements (which we refer to as P2P agreements).[3]
- Firms that operate or plan to operate investment-based crowdfunding platforms on which consumers can buy investments, such as equity or debt securities that are not listed or traded on a recognised exchange, or units in an unregulated collective investment scheme.
- Firms that use offline media to communicate direct offer financial promotions for non-readily realisable equity or debt securities to retail clients[4], and firms that approve such promotions.

1 The CP is available at: www.fca.org.uk/static/documents/consultation-papers/cp13-13.pdf. The CPs dealing with our approach to consumer credit are available at: http://www.fsa.gov.uk/static/pubs/cp/cp13-07.pdf and www.fca.org.uk/static/documents/consultation-papers/cp13-10.pdf.

2 In a separate paper, we set out rules for the protection of borrowers on loan-based crowdfunding platforms. See PS14/3, Detailed rules for the FCA regime for consumer credit, February 2014: www.fca.org.uk/static/documents/policy-statements/ps14-03.pdf

3 The new activity only applies to loans meeting certain criteria. These include: the investor and/or borrower must be
i) an individual;
ii) a partnership consisting of two or three persons not all of whom are bodies corporate; or
iii) an unincorporated body of persons which does not consist entirely of bodies corporate and is not a partnership.
So business-to-business loans that do not meet these criteria will not be regulated by the FCA.

4 This paper is not relevant if the retail clients receive regulated advice or investment management services in relation to those investments, or are corporate finance contacts or venture capital contacts.

Context

1.4 Crowdfunding is a way in which people, organisations and businesses, including business start-ups, can raise money through online portals (crowdfunding platforms) to finance or re-finance their activities. Some crowdfunding activity is unregulated, some is regulated and some is exempt from regulation.

1.5 The crowdfunding sectors have grown in recent years as a result of two key factors: technological innovation and the financial crisis, which has led to constraints on lending by traditional credit providers to the real economy.

1.6 On 1 April 2014, the regulation of the consumer credit market will transfer from the Office of Fair Trading (OFT) to the Financial Conduct Authority (FCA). This includes responsibility for regulating loan-based crowdfunding.

1.7 Crowdfunding already falls within the scope of regulation by the FCA if it involves a person carrying on a regulated activity in the UK, such as arranging deals in investments, or the communication of a financial promotion in relation to securities. If a crowdfunding platform enables a business to raise money by arranging the sale of equity or debt securities, or units in an unregulated collective investment scheme, then this is investment-based crowdfunding. As such, it is regulated by the FCA and the firm operating the crowdfunding platform needs to be authorised, unless an exemption is available.

1.8 In this paper we outline the new regime that will apply to firms operating loan-based crowdfunding platforms. We also update the regime applying to firms that operate investment-based crowdfunding platforms or carry on similar activities.

1.9 This approach is designed to advance the FCA's objectives of:

- securing an appropriate degree of protection for consumers, and
- promoting effective competition in the interests of consumers.

Summary of feedback and our response

1.10 We received 98 responses through the consultation process, which closed on 19 December 2013. Respondents included consumer organisations, individual consumers, firms, trade bodies, support businesses and other interested parties.

Loan-based crowdfunding

1.11 In the CP we proposed to apply the FCA Principles and core FCA provisions to firms running loan-based crowdfunding platforms. These provisions include conduct of business rules (in particular, around disclosure and promotions), minimum capital requirements, client money protection rules, dispute resolution rules and a requirement for firms to take reasonable steps to ensure existing loans continue to be administered if the firm goes out of business.

1.12 Respondents generally agreed with our approach and we are taking forward most of the proposals set out in the CP.

1.13 The principal concern respondents had related to capital requirements. We proposed that firms must hold a minimum amount of regulatory capital in order to ensure they behave prudently

in monitoring and managing business and financial risks. Many respondents agreed with this suggestion, with some believing the proposed requirements were too low. However, many respondents who addressed this subject felt that the proposed requirements were too high or suggested an alternative calculation method. After consideration of this feedback we are taking forward an amended approach that will result in lower capital requirements for some firms in this sector.

Investment-based crowdfunding and similar activities

1.14 Given the significant risks investors face when investing in unlisted securities that are hard to value independently or sell on a secondary market, we proposed that firms offering such investments on crowdfunding platforms (or using other media) promote only to certain types of investor. These are:

- professional clients,
- retail clients who are advised,
- retail clients classified as corporate finance contacts or venture capital contacts,
- retail clients certified as sophisticated or high net worth, or
- retail clients who confirm that they will not invest more than 10% of their net investible assets in these products.

1.15 Where no advice has been provided to retail clients we also proposed to apply the appropriateness test, so all firms (both MiFID and non-MiFID) would need to check that clients have the knowledge or experience to understand the risks involved.

1.16 We proposed rules that would apply to 'unlisted shares' and 'unlisted debt securities', intending to identify difficult-to-value, illiquid securities. Some respondents asked for clarification of what was meant by these terms and, in particular, whether they applied to securities traded, or soon to be traded, on a recognised investment exchange or designated investment exchange[5] such as the Alternative Investment Market. As explained in the CP, we did not intend that liquid, traded securities are affected – only those securities for which there is no acceptable secondary market. After considering respondents' comments, we propose to replace the terms 'unlisted share' and 'unlisted debt security' with a new defined term, 'non-readily realisable security', to more clearly describe the intended scope of the proposed rules.

Next steps

What will we do?

1.17 The rules set out in Appendix 1 come into force on 1 April 2014, subject to certain transitional arrangements. We will review the implementation of the new rules by the end of this year, and we plan to carry out a full post-implementation review of the crowdfunding market and regulatory framework in 2016 to identify whether further changes are required.

5 A 'recognised investment exchange' is an investment exchange declared by a recognition order made under section 290 or 292 of FSMA 2000. A 'designated investment exchange' is one of the overseas investment exchanges listed in the FCA Glossary under this defined term.

What do you need to do next?

1.18 If your firm is affected by these rules, you should consider the changes you need to make.

1.19 Before investing, consumers can find out if we regulate a firm. The Financial Services Register of firms is available at http://www.fsa.gov.uk/register/home.do. Consumers can ask questions or report any concerns they have by calling our Consumer Contact Centre on 0845 606 9966 or by email to fcc@fca.org.uk.

2. Regulatory considerations

2.1 This chapter summarises the feedback received on the first four questions posed in the CP, and sets out our responses.

Equality and diversity

Q1: Do you have any comments on our assessment of the equality and diversity considerations?

2.2 In the CP, we considered whether use of crowdfunding platforms involves risks for vulnerable investors such as those with learning difficulties, and some elderly and young investors. Vulnerable investors may be more susceptible to emotive advertising highlighting the social benefits of the investment, or high headline rates of return compared to lower interest rates on deposit accounts. Younger investors may also be more susceptible to social network promotion of platforms. To guard against this, we suggested that we would place particular emphasis on the need for communications to these groups to be fair, clear and not misleading.

2.3 We received 30 responses to the question posed about equality and diversity considerations. Approximately half of these agreed with the assessment and half disagreed.

2.4 Of those who agreed, some noted that all communications to consumers, not just to the protected groups, should be fair, clear and not misleading.

2.5 Of those who disagreed, most respondents argued that there may be benefits to all consumers, including those in the protected groups, from investing via crowdfunding platforms; and that most investors understand the risks and it is unnecessary to pay special attention to these customer groups or to try to stop them from investing. Some went further and stated that there is no evidence of problems in the market for these groups.

2.6 Three respondents argued that the proposed focus on disclosure, and the level of disclosure proposed in the CP, is insufficient to mitigate the risks for these consumers. One suggested that the marketing restrictions proposed for investment-based crowdfunding should be expanded to restrict the promotion of regulated products on crowdfunding platforms to certain protected groups of consumers. Two respondents said that investment-based crowdfunding is more likely than loan-based crowdfunding to lead to problems for the protected groups.

Our response

There appears to be some misunderstanding of the purpose behind our assessment of the equality and diversity considerations.

The public sector Equality Duty (section 149 of the Equality Act 2010) applies to public bodies and others carrying out public functions. It supports good decision-making by ensuring these entities consider how different people will be affected by their activities, helping them to deliver policies which are effective and which meet different people's needs. The Equality Duty is supported by specific duties, which require public bodies to: publish relevant, proportionate information demonstrating their compliance with the Equality Duty; and set themselves specific, measurable equality objectives.

So, in exercising our duties, we are obliged to consider the possible impact of our proposals on certain specified groups of people with identifiable characteristics (such as age, gender and ethnicity). Where we identify possible issues that may arise, we need to consider how our proposals can mitigate risks to those groups and how we can advance equality of opportunity between people who share a protected characteristic and those who do not.

We do not think any specified group of consumers necessarily suffer harm at present. However we recognise that certain types of consumer in the protected groups may be more at risk from poor disclosure and, therefore, we will take this into account when assessing the compliance of communications to these groups.

Types of crowdfunding

Q2: Do you agree with our assessment of unregulated, exempt and regulated crowdfunding activities?

2.7 In the CP, we identified five main types of crowdfunding, noting that only firms engaged in the final two types will be within the FCA regulatory remit.

- Donation-based: people give money to enterprises or organisations whose activities or purchases they want to support.
- Pre-payment or rewards-based: people give money to receive a reward, service or product (such as tickets for an event, an innovative product, a download of an e-book or a new computer game).
- Exempt: people invest or lend money using organisations or investments that satisfy the requirements in statutory exemptions to be considered exempt from the need for FCA authorisation or regulation (such as Enterprise Schemes or withdrawable shares issued by Industrial and Provident Societies).
- Loan-based: people lend money to individuals or businesses in the hope of a financial return in the form of interest payments and a repayment of capital over time (this excludes some business-to-business loans).

- Investment-based: people invest directly or indirectly in new or established businesses by buying shares or debt securities, or units in an unregulated collective investment scheme.

2.8 Most responses to this question agreed with our approach. A range of points were made, some of which we address elsewhere in this PS. The key points were:

- Some respondents suggested alternate approaches to categorising the various crowdfunding models. They also mentioned other types of crowdfunding which may be outside the FCA remit, such as invoice factoring platforms.
- Some respondents suggested that the 'crowdfunding' term should only apply to 'investment-based crowdfunding' and not 'loan-based crowdfunding' which they thought best described as 'peer-to-peer lending'.
- One respondent suggested a low threshold for investment so that anyone investing less than £250, for example, could do so without the firm being subject to restrictions.

Our response

While different ways of categorising crowdfunding exist, we do not consider that we need to change our approach.

We use the term 'loan-based crowdfunding' for concision, to cover a number of different models. Some loan-based crowdfunding platforms facilitate loans from individual investors to other individuals (peer-to-peer lending), while others facilitate loans from individuals to businesses (peer-to-business lending) and others allow a combination. The term 'loan-based crowdfunding' also indicates that this model is part of a spectrum of different crowdfunding models. Some platforms include more than one type of crowdfunding model and we think it makes sense to use an inclusive term. This is not a required term to be used by firms. We accept that loan-based crowdfunding includes peer-to-peer lending and we also use the term 'P2P agreement' as shorthand to describe the loan agreements arranged. Firms can use the term 'peer-to-peer' where that is appropriate for their business model, so long as their communications are fair, clear and not misleading.

Finally, we do not consider it appropriate to apply lower standards, or fewer consumer protections, if a consumer has less money to invest.

Transitional provisions

Q3: Do you agree with our proposals for transitional periods?

2.9 As we want firms to have time to adjust their business models, we proposed a series of transitional provisions for the introduction of the rules on which we consulted.

2.10 For loan-based crowdfunding we proposed the following transitional periods.

- Firms with a valid OFT licence on 31 March 2014 will be able to continue carrying on the consumer credit activities they are licensed for until they become fully authorised, as long as they notify us of some basic information and pay a fee. These firms will be granted an 'interim permission'.
- Before 1 April 2016, all firms with an interim permission that want to carry on regulated activities should have applied for, or had granted, full authorisation as well as approval for individuals carrying on certain controlled functions.
- New firms running loan-based crowdfunding platforms from 1 April 2014 or firms that do not hold a consumer credit licence from the OFT on 31 March 2014 will need to apply immediately for full authorisation and approval for individuals carrying on certain controlled functions.
- Minimum prudential requirements will not start until a firm is fully authorised.
- We are proposing to introduce a transitional period for certain rules, allowing firms with an interim permission until 1 October 2014 to adjust their processes to meet the standards required. However certain high-level requirements will apply, such as the fair, clear and not misleading communications rule, from 1 April 2014.

2.11 For investment-based crowdfunding and similar activities we proposed a transitional period allowing firms the option of either complying with the new rules from 1 April 2014, or complying with existing rules until 1 October 2014 and then applying the new rules from that date.

2.12 A number of respondents discussed the proposed transitional arrangements in their feedback. Most agreed with the proposals and some made some further observations:

- While agreeing with the approach, one respondent said it is vital that the FCA actively monitors those firms operating loan-based crowdfunding platforms with interim permission throughout the period before full authorisation to ensure acceptable standards are met.
- Existing firms operating loan-based crowdfunding platforms may find it challenging to implement proper arrangements for client money by 1 October 2014.

2.13 Respondents who disagreed with the proposals did so for a number of reasons.

- Some respondents argued that the transitional periods should be extended as the industry is still in its infancy and to avoid creating additional barriers to entry.
  - One respondent made this point in relation to the client money rules for firms operating loan-based crowdfunding platforms. The client money rules are subject to a separate consultation and may change in the future so this respondent suggested a longer transitional period.[6]
  - A few respondents said they feel that the timetable for rule changes for investment-based crowdfunding platforms is too tight. These respondents also felt that more time should have been available for consultation.

6 See FCA, CP13/5, *Review of the client assets regime for investment business*: www.fca.org.uk/static/documents/consultation-papers/cp13-05.pdf, July 2013

- One agreed broadly with our approach but suggested that the proposals would disproportionately affect charities, and social enterprises that arrange deals in their own securities, which may not have the skills or compliance systems required. It was suggested that these entities would need longer to adjust.

- One suggested that we should not be developing a national approach to the regulation of crowdfunding at all and, instead, should wait for the EU to legislate.

Our response

The rules in this PS introduce the transitional periods on which we consulted. We consider these to provide adequate time for firms to adapt their processes to meet the new standards, including firms working in the charitable or social investment sectors.

While we are consulting on changes to the rules for client money handling, which will affect firms running loan-based crowdfunding platforms, we do not consider it appropriate to leave investors unprotected pending those changes, so we are not extending the transitional arrangements for affected firms.

We consider the rules we are introducing to be consistent with existing European directives and we will ensure they remain consistent.

Other risks

Q4: Do you think there are other risks relating to crowdfunding that we should consider and seek to address?

2.14 In the CP we identified some key risks for investors using crowdfunding platforms and asked respondents to identify any other risks that we should consider. Most respondents accepted the risks as set out in the CP, and some suggested further risks we should consider.

2.15 The following additional risks were identified for all types of regulated crowdfunding:

- Some said the principles-based approach proposed for the regulation of crowdfunding carries risks as it leaves scope for firms to decide how they meet certain requirements. For example, we do not prescribe minimum standards of due diligence or disclosure. One respondent also noted that our proposed rules do not require firms running loan-based crowdfunding platforms to actively pursue defaulters for outstanding debts, which might reduce the risks to investors, but leave it to firms to determine their own approach to dealing with loans in default.

- Investor over-optimism could be a risk if investors are inexperienced and if due diligence or disclosure has been poor. This could lead to further problems for the industry if investors subsequently claim they have been misled and seek redress.

- Insider trading might be a problem if platform employees or connected persons use information to trade in investments before information becomes public knowledge.

- Problems with technology, IT security or the internet could also lead to risks for investors. Systems failures, for example, could delay or prevent the sale of investments on a secondary market. Consumer data may also be vulnerable if security measures prove insufficient.

- Many of the firms running platforms lack regulatory experience or, with regard to loan-based crowdfunding, lending experience. This lack of experience may result in detriment for investors.

- One respondent said that the risk of platform failure is a higher risk issue than the CP indicates, and the cost of an operational failure could easily exhaust the proposed prudential requirements for loan-based platforms.

- The risk of lack of continuity in the event of an investor's death was also mentioned.

2.16 The following additional risks were identified in relation to loan-based crowdfunding:

- It was suggested that there is a risk that platforms which offer both the ability to invest in specific loans and to 'auto lend'[7] create a risk that sophisticated investors will choose individual loans and cherry pick the better opportunities, leaving the poorer quality loans for auto-lending investors.

- It was noted that contingency funds for loan-based platforms may not provide as much security as investors expect if the default rate increases suddenly and exhausts the fund. One respondent suggested that the capital requirements should be higher for firms operating contingency funds in order to reduce this risk.

- The proposals to ensure existing loans continue to be administered if the platform fails may not work in practice if, for example, they depend on a third party which also goes out of business.

- Investors on loan-based platforms may be locked into loan agreements that run for a number of years and provide fixed levels of interest, which may become less attractive if interest rates in the wider economy increase.

2.17 The following additional risks were identified in relation to investment-based crowdfunding.

- Some respondents felt the risks of start-up crowdfunding had been underplayed. While it is clear that more than half of start-ups fail in the early years, one said there is no evidence that the surviving businesses would themselves produce any return in practice. Another said that it will take years for some problems to be recognised and, given the infancy of the market, investors are at present unaware of the level of risk they are accepting.

- It was suggested that firms do not always undertake sufficient due diligence and the risks to investors are far higher than we described. Some respondents claimed that many published business plans are technically flawed and some information supplied on platforms can be misleading.

- One response noted that, apart from filing annual accounts at Companies House, there are few requirements for the businesses invested in to report on their performance to shareholders. Where large numbers of investors make small investments, one respondent suggested that there should be additional reporting requirements to give investors more

7 Where investors instruct the platform to lend their money to multiple borrowers

information to assess the fairness of dividend and dilution decisions.

- Some respondents noted that some firms currently running platforms do not hold the required regulatory permissions and may not meet our regulatory standards.

- One respondent mentioned that multiple funding rounds could lead to increased complexity for investors seeking to manage their existing investment and avoid the dilution of shareholder value. Linked to this, they noted the risk that other shareholders may receive more rights (anti-dilution rights or better, alternative share classes). While the respondent felt that this may be acceptable, they noted that currently these risks are not always clearly disclosed to investors.

- One respondent noted that some platforms operate a nominee structure, which is likely to be primarily for the benefit of the investee companies since they only have to interact with one investor rather than many. This, they said, may appear to provide investor protections, like those provided by an active venture capital fund manager, so some investors may feel they need to conduct less oversight.

2.18 Some respondents disagreed with our assessment of risks or suggested a different approach:

- Several respondents referred to the risk of over-regulation damaging the financing of small and start-up enterprises, and the possibility that regulation will act as a barrier to entry for new platforms.

- Some argued that treating all unlisted securities as high risk could make selling social investments difficult and reduce the number of investors in that market.

- Some respondents even argued that platforms offering high-cost short term, high interest loans are not necessarily higher risk.

- One respondent suggested that the level of risk should be considered in the wider context, specifically by comparison to gambling.

2.19 Some respondents suggested the FCA should outline the due diligence processes firms should follow, and the level of diversification investors should seek to mitigate risks.

Our response

While we acknowledge that crowdfunding and similar activities may benefit the economy, those seeking finance, and some investors, we are also obliged to consider the wider financial market and the need to protect consumers generally.

In order to create a proportionate framework that balances regulatory costs against benefits, we are not prescribing how firms should address or disclose the relevant risks. Nor are we proposing to set requirements for minimum standards of due diligence at this stage. At present, it is for firms to determine the risks present in their business models and to develop appropriate processes to deal with them.

We think our approach provides adequate investor protection and sufficient flexibility for firms to operate and arrange finance for small and medium enterprise.

However, greater prescription is an option that the FCA may consider in the future, depending on how the market evolves. We will review the market and our regulatory approach in the coming years.

"High-cost short-term" referred to payday loans. We consider these to be higher risk than other types of loan, such as those made to borrowers with easy access to credit.

We will consider the issues flagged by respondents when supervising this market. We also acknowledge that further risks may materialise in the future as the sector evolves and will aim to identify those risks on an ongoing basis.

The FCA does not regulate gambling so it is not for us to comment on this sector.

Social investments

2.20 Several respondents suggested that it was not appropriate to restrict promotions for 'social investments' that raise money for a good cause in the same way as promotions for other investments. They noted that applying restrictions could act as a disincentive and limit growth in this sector. They also argued that social investors are not primarily focused on monetary profit and are more willing to accept the risk of capital loss.

Our response

At present, if an investment activity falls within FCA scope, our rules apply to firms carrying on regulated activities or communicating promotions in relation to investments labelled as 'social investments', 'ethical investments' and 'environmental investments', just as they would in relation to any other designated investment. We do not consider an investment's social or other non-financial objective to be a reason to reduce consumer protection when the same risks of potential capital losses and illiquidity can apply. However, consideration will be given to commenting on this sector further after the scope of the Government's planned social investment tax relief is known (due to take effect in April 2014).

We consider it possible for social investments to be promoted and sold to retail investors in ways that comply with our conduct of business rules. We also consider it possible for some social investments to fall outside our regulatory scope, as is the case with unregulated donations-based crowdfunding and when legislative exemptions apply. For example, due to exemption, the FCA does not regulate Enterprise Schemes, Industrial and Provident Societies marketing their own withdrawable shares.

3.
Loan-based crowdfunding

3.1 This chapter summarises the feedback received in relation to our proposals for firms operating loan-based crowdfunding platforms, and our response to it.

Summary of feedback and our responses

Recourse to the Financial Services Compensation Scheme

*Q5: **Do you agree that we should not include loan-based crowdfunding platforms within the remit of the Financial Services Compensation Scheme (FSCS)?***

3.2 In the CP we said that we are not proposing to include loan-based crowdfunding platforms within the remit of the FSCS. When looking at the amount of loss investors might suffer if a platform failed and the amount that would be covered by the FSCS, we did not consider that there is justification to include loan-based crowdfunding within the FSCS jurisdiction at this time.

3.3 We received 41 responses to the question we asked about this proposal. Of these, 28 agreed that loan-based crowdfunding platforms should not fall within the remit of the FSCS and 13 disagreed.

3.4 Some of the respondents who agreed with our proposal made additional observations:

- Some felt that this situation should be kept under review as, while it is appropriate at present, since the market is embryonic, this may change in the future if loan-based crowdfunding becomes a significant investment for a large proportion of investors
- The fact that a platform is not within the remit of the FSCS must be made clear to investors.
- Platforms should also make clear that un-lent funds are held in a bank account which would be within the remit of the FSCS.

3.5 Respondents who said that loan-based crowdfunding platforms should fall within the FSCS remit made the following points:

- Most of these respondents felt that loan-based crowdfunding should be treated in the same way as other investments as this would give additional protection to investors where a platform fails, or if the firm running the platform used client funds for its own purposes, was negligent or committed fraud.
- Others made the point that lack of recourse to the FSCS could reduce new investment.

- One respondent suggested that platforms should be within the FSCS remit if this only leads to a small charge for firms.
- One respondent thought that requiring the firms running platforms to meet minimum prudential requirements seems contradictory to a lack of recourse to the FSCS.

Our response

We agree with the respondents who noted that it is important for the regulatory framework to be proportionate, especially while the market is young and growing. Bringing these firms within the FSCS remit would impose additional regulatory costs, which may be quite significant.

We do not consider that it would currently be proportionate to include loan-based crowdfunding platforms within the FSCS remit. As loan-based crowdfunding is not currently within the FSCS remit, we do not expect this to lead to a reduction in new investment. Firms should ensure that investors understand the risks involved.

Other protections that we are introducing – such as the minimum capital standards and the requirement for firms to have arrangements in place to continue to administer loans in the event that the platform fails – should provide adequate protection at this time. We do not consider that it is contradictory for these firms to be subject to some regulatory requirements but not others.

Overall, we believe that the approach we are adopting is proportionate and appropriate for the market and the risks it carries at present.

We have committed to review the crowdfunding market and our regulatory framework for it in 2016 and, at that stage, will consider again whether loan-based crowdfunding should be within the remit of the FSCS.

Prudential standards

Q6: Do you agree with the prudential standards proposed for loan-based crowdfunding firms? If not, what amendments would you make and why?

3.6 In the consultation, we proposed that firms operating loan-based crowdfunding platforms should hold regulatory capital to help them withstand any future financial shocks. The proposals were as follows:

- Between 1 April 2014 and 31 March 2017, the financial resources requirement will be the higher of:
  - a fixed minimum amount of £20,000; or
  - (0.3% of the first £50m lent by investors) + (0.2% of the next £450m lent by investors) + (0.1% of all money lent above £500m).

- From 1 April 2017, the financial resources requirement will be the higher of:
  - a fixed minimum amount of 50,000; or
  - (0.3% of the first £50m lent by investors) + (0.2% of the next £450m lent by investors) + (0.1% of all money lent above £500m).

3.7 There were 36 responses to this question. The majority agreed with the need for a financial resources requirement; several respondents agreed with the consultation proposals as they stand, while some respondents felt that the prudential calibration was too low. In contrast, a number of respondents felt that the calibration was too high or proposed alternative metrics. The detailed responses can be categorised as follows.

Financial resources requirement calibration

3.8 Respondents suggested that the calibration of our preferred metric should be adjusted to better reflect economies of scale. Examples include:

- introducing the 0.1% tier at a lower amount of 'total value of loaned funds outstanding';
- having an absolute cap on the amount of capital that must be held; and
- incorporating a further tier, set at 0.05%, where loaned funds exceed a certain amount.

Alternative financial resources requirement metrics

3.9 Several respondents proposed different approaches to calculate the financial resources requirement. In some cases they suggested that an expenditure-based requirement would be preferable; in other words, firms hold sufficient prudential resources to run their business for a set period. In other cases, respondents suggested that there should be more variables included in the prudential requirements metric to reflect whether the firm holds client money or not and the types of loans the firm facilitates.

Notification process and prudential requirements recalculation:

3.10 Some responses suggested that the requirement for firms to notify the FCA if their total value of loans outstanding increases by at least 15% was too low. They argued that in a rapidly growing market this would mean that firms would be reporting and recalculating their prudential requirements too frequently.

Our response

The regime we proposed was designed to be understandable and pragmatic, balancing the need to protect consumers while also aiming to facilitate market competition.

Financial resources requirement calibration
We understand the responses suggesting that we should recalibrate our tapered metric percentages to reflect economies of scale in extremely large firms. We are responding to this by:

- re-calibrating the metric so that prudential requirements are slightly reduced for firms which are subject to the volume-based requirement; and
- inserting a further tier into the metric for the very largest firms.

The revised volume-based financial resources requirement calibration is the sum of:

a. 0.2% of the first £50 million of total value of loaned funds outstanding;

b. 0.15% of the next £200m of total value of loaned funds outstanding;

c. 0.1% of the next £250m of total value of loaned funds outstanding; and

d. 0.05% of any remaining balance of total value of loaned funds outstanding above £500m.

Alternative financial resources requirement metrics
We still consider that our preferred metric of 'total amount of loaned funds outstanding' is more appropriate than a financial resources requirement based on 'annual fixed operating costs'. This is because we do not think that the fixed operating costs metric captures all of the prudential risks associated with loan-based crowdfunding. In contrast, our preferred metric is the most appropriate to capture prudential risks such as the likelihood of holding large amounts of client funds, the length of time to wind down a firm, and the complexity of the firm. The prudential requirement also increases with the size of the firm to ensure that firms continue to provide adequate consumer protection and to reflect the potential for larger firms to disrupt markets if they fail.

In response to suggestions that we should incorporate more variables into the financial resources requirement calculation, we have always stated that one of our principles is to have a prudential regime that is not overly complex. We stand by this principle, especially as we are designing a regime for firms that are new to prudential standards.

Notification process and prudential requirement recalculation
We believe that the notification and recalculation process is important to ensure that firms hold sufficient prudential resources, particularly in a rapidly growing market. However, to avoid the need for too frequent prudential requirements recalculation we propose to increase the notification threshold from 15% to 25%. As a result, for firms that are experiencing strong growth, prudential

requirements will still increase during the year, but these increases will be spread out slightly to help firms manage the change.

We reiterate a few points that were raised in consultation responses:

- The prudential requirements metric is the total value of the firm's loaned funds outstanding at the calculation date. It is not the total amount of cumulative loans that the firm may have provided during the lifetime of the firm (assuming that some loans may have been repaid by borrowers).

- The types of financial resources that a firm must hold to meet their financial resources requirement are detailed in IPRU(INV)12.3.2R.

Q7: Do you agree with the transitional approach proposed for the financial requirements for loan-based crowdfunding firms?

3.11 To help firms adapt to the new regime, we proposed that the final prudential requirements would not come into force immediately. The transitional proposals were as follows:

- Until 31 March 2017, the fixed minimum prudential requirement for firms will be £20,000. This will reduce barriers to entry for firms in the early part of our regime and also provide firms with adequate time to prepare for, and to meet, our full prudential standards regime from 1 April 2017.

- Until 31 March 2017, firms will not need to deduct 'investments in subsidiaries' and 'intangible assets' when calculating their prudential resources.

- The transitional arrangements will apply to **all firms** once they become fully authorised and will do so until 31 March 2017. Existing OFT-regulated loan-based crowdfunding firms will not be subject to our prudential standards until they become fully authorised.

3.12 29 respondents addressed this question; the overwhelming majority of whom agreed with the proposals. Of those who disagreed, one suggested that the transitional arrangements should finish sooner, because the final fixed minimum prudential requirement of £50,000 should be achievable for all firms that operate effective platforms. Two respondents argued that the transitional fixed minimum prudential requirement of £20,000 should be the final fixed minimum arrangement, or a lower value used instead.

Our response

As loan-based crowdfunding firms have little or no experience in dealing with prudential standards, we believe we should give firms time to adapt to the new requirements. We consider that we proposed suitable transitional periods and, therefore, we are proceeding with our existing timetable for introducing prudential standards. This approach is consistent with how we have introduced prudential requirements in the past for other firms new to prudential regulation.

We believe that loan-based crowdfunding firms pose a risk to consumers, and we continue to believe that fixed minimum prudential requirements of £20,000 (for the transitional period) and £50,000 for the final policy are consistent with this risk.

We reiterate that the transitional arrangements will apply to **all firms** once they become fully FCA-authorised and will do so until 31 March 2017. We also remind firms that existing OFT-regulated loan-based crowdfunding firms will not be subject to our prudential standards until they become fully FCA-authorised.

Client money rules

Q8: Do you agree that firms running loan-based crowdfunding platforms should be subject to our client money rules?

3.13 Firms that hold client money in relation to investment business are subject to the client money rules contained in our Client Assets sourcebook (CASS). These rules require firms to ensure adequate protection of client money when the firm is responsible for it. We proposed to apply these rules to protect investors on loan-based crowdfunding platforms.

3.14 We received 37 responses to this suggestion and 26 respondents agreed with the proposal. One agreed that the client money rules in the client assets sourcebook (CASS) should apply to commercial crowdfunding platforms but said they should not apply where the platform solicits finance for wholly charitable or social purposes.

3.15 One respondent said that it is important that investors understand that the amount of money they receive if a platform collapses will be affected by the costs of the insolvency practitioner.

3.16 Some noted that firms running loan-based crowdfunding platforms can structure their business models in such a way that they do not hold client money. It is possible to use a payment services firm or to delegate responsibility to a third party.

3.17 One respondent asked for clarification on when and where client money rules apply for platforms that operate 'pledging models' (where investors promise to pay a certain amount and a direct debit is taken from their account on deal execution) and 'platform account models' where money is collected at the time of the pledge.

3.18 Some argued that the rules in CASS 1A should not apply to firms running loan-based crowdfunding platforms on the basis that they are too great a burden. CASS 1A is a section of our rulebook that applies some additional requirements to firms that meet the thresholds to be considered as CASS medium or large firms.[8] These additional requirements include the obligation to submit a Client Money and Assets Report (CMAR) each month and to allocate to a director or senior manager responsibility for client money oversight and reporting to senior management.

3.19 Some respondents said that the regime for insurance intermediaries in CASS 5 is more appropriate to loan-based crowdfunding than the CASS 7 regime. They said, for example, that the concept of acting as intermediary is more easily adaptable to the crowdfunding model and so they thought CASS 5 should be the base from which the loan-based crowdfunding client money rules are formed. As with insurance intermediaries under CASS 5, these respondents argued that loan-based platforms should not be subject to the CASS 1A operational requirements.

8 Firm classification under CASS 1A.2 is based on an annual stratification exercise. Firms holding less than £1m in client money are classed as CASS small firms, firms holding an amount of client money greater than or equal to £1m but less than or equal to £1bn are CASS medium firms, and firms holding more than £1bn in client money are CASS large firms.

3.20 One respondent noted that the CASS regime as a whole is subject to a far-reaching consultation and suggested that the application of the regime to firms running loan-based crowdfunding platforms needs to take account of these proposals and ensure that they are appropriate.

3.21 Another respondent noted that the limited implementation time available may prove challenging for some firms.

3.22 Two respondents disagreed with the proposal in full. They argued that the rules are burdensome and expensive, particularly for smaller firms in this market. As alternatives, these respondents suggested that the client money risks should be disclosed but no mitigating measures introduced, or that the thresholds firms are assessed by for the purposes of these rules should be revised and bespoke definitions be developed for this market.

Our response

There was general support for our proposal to apply CASS to loan-based crowd funding platforms. Where finance is sought for charitable or social purposes, we do not think it appropriate to provide a lower degree of protection for investors. We have adopted a similar approach regarding debt management firms receiving client money, where we have also stated that we do not think it is appropriate to apply a lower standard of protection in the not-for-profit sector.

We agree that it is important to note that the amount of money returned to clients in the event of insolvency will be affected by the insolvency practitioner's costs in returning that money. We mentioned this in CP13/13, highlighting that CASS does not amount to a compensation regime. Under the terms of the statutory trust, the costs properly attributable to the distribution of client money can be paid using the client money held.

Where a firm operates a 'pledging model', the firm will only have to segregate money it has actually received from clients, not money that has merely been pledged. If a firm receives money from clients after that money has been pledged, before passing this money on to a borrower, the firm will need permission to hold client money. The client money rules are applicable even if the money is held for a short time.

Some felt that it would be possible to structure their businesses in such a way as to avoid holding client money at all. While this may be possible, firms attempting to do so must ensure that any arrangements they make comply with the rules.

We disagree that the requirements of CASS 1A are overly burdensome on firms. Although the requirements entail some additional reporting for CASS medium and CASS large firms, this should not be difficult for firms to provide. It is important for the regulator to be clear on the sums of money held by firms in a rapidly developing sector in order to monitor risks, and we differentiate between firms (small, for which data are not required monthly, medium or large, for which it is) to help us to do this. We do not believe it is sufficient simply to disclose risks to clients and believe that CASS is an appropriate way to mitigate these risks.

We disagree with those who consider that CASS 5 for insurance intermediation would be a more suitable starting point for firms undertaking loan-based crowdfunding. Loan-based crowdfunding is a type of investment activity, so should be subject to the rules for investment business. While there are some similarities regarding possible payment flows, one major difference is that we understand that a number of firms will be accruing balances of client money, from lenders, for some time before these are passed on to borrowers. Furthermore, the repayments on loans are regular payments over a set (potentially lengthy) period of time, rather than claims money returned to policy holders via an intermediary or premiums being passed to an insurer in the CASS 5 regime.

We also note that we consulted on the client money rules for insurance intermediaries in FSA CP12/20, so current requirements could change.[9]

As raised in CP13/13, we noted that CASS is currently still undergoing consultation following CP13/5,[10] and that all firms should take note of potential changes to the rules and future developments. The policy statement following CP13/5 is scheduled to be published in the first half of 2014. The transitional provision we are introducing means firms will not be subject to CASS until October 2014, allowing time for firms to consider what they need to do to meet the requirements.

In CP13/13 we consulted on a rule to require loan-based crowd funding firms to use a particular method of reconciliation. We still intend to make this change and have not changed our policy, but will publish the final rule in March and not in the attached instrument. This is to ensure that we fully take into account any Handbook drafting that will need to be amended following CP13/5. Transitional provisions in the attached instrument should ensure that in any case, this does not affect firms.

In CASS 7, we require firms to conduct internal reconciliations to ensure that they hold the right amount of client money. In CP13/13 we consulted on a rule to prevent firms from using the individual client balance method as part of a standard method of internal reconciliation in relation to loan-based crowdfunding business. The guidance around this method is not drafted in a way that is relevant to loan-based crowdfunding because, for example, it refers to sale proceeds and costs of purchases. We are going to make the proposed change but will do so at a later stage.

The rule that appeared in CP13/13 was drafted to sit within the draft rules proposed in CP13/5, which we expected to make before publishing this PS. However, this has not been the case, and we need further time to reconsider how to achieve this within the context of the CASS 7 rules and guidance that will apply to loan-based crowdfunding firms.

9 *Review of the client money rules for insurance intermediaries*, CP12/20, August 2012: www.fca.org.uk/static/pubs/cp/cp12-20.pdf

10 *Review of the client assets regime for investment business*, CP13/5, July 2013: www.fca.org.uk/static/documents/consultation-papers/cp13-05.pdf

Following publication of the newly drafted provision, should a firm wish to use the individual client balance method, it may approach us directly and we will consider any points raised. Alternatively, firms will still be able to use the individual client balance method or even another method as part of a non-standard method of internal reconciliation (requiring auditor sign off).

Q9: Do you agree that money held by the failed platform at the primary pooling event should be returned only to relevant investors?

3.23 On certain occasions, such as insolvency, CASS provides that a primary pooling event will occur. Our client money distribution rules (CASS 7A) provide for how client money must be distributed back to clients following a primary pooling event. We consulted on the basis that money held by the failed platform at the primary pooling event should be returned only to relevant investors. Of the 31 responses to this, 26 agreed with the proposal.

3.24 Other respondents suggested that there are two scenarios to consider: first where the loan funds have been paid into the client account, but this loan has not yet been drawn down; and second where a repayment has been made by the borrower to the client account. In the first scenario they suggest the money should be paid to the borrower. In the second, they agree the money should be paid to the investor.

3.25 We were also asked for clarification on two matters:

- The CP stated that there could be a shortfall 'due to losses relating to a different type of business carried out by the firm'. One respondent asked whether this undermines the ring-fencing of client money and whether consumer protection could be lost.
- Another respondent asked for confirmation of who the client is for client money purposes: the investor, the borrower or both?

Our response

We note the considerable support for this proposal.

We do not agree with the minority of respondents who felt that money held by a failed platform in respect of a loan not yet drawn down should be paid to the borrower. There are a number of difficulties here, including that the platform will not be in a position to administer the loan following the insolvency, and that following the insolvency practitioner's calculation of the client money requirement, resource and entitlement, there may be a shortfall. This could mean a shortfall for the party for whom the loan monies were intended. In addition, we do not think it is appropriate for CASS to require firms to implement further segregation between repayments from borrowers and monies yet to be paid out to borrowers due to the additional operational complexities.

If a firm is conducting other types of business, for example investment business, and then fails, then all the client money held by the firm will be notionally pooled under CASS 7A, and returned to clients in accordance with their entitlement. If there is a shortfall in the money held by the firm, that is to say, if the firm was not holding enough money for any reason, then this shortfall will

be calculated by the insolvency practitioner and borne by clients on a pro rata basis. The insolvency practitioner's costs in relation to distributing client money to clients are also borne by the client money held by the firm. This means that if the firm fails, all clients share in any client money shortfall, regardless of the type of business they did with the firm. The firm must still segregate money and it is still held on trust under CASS.

As noted in CP13/13 in paragraphs 3.38 to 3.42 (Client money in the event of an insolvency or a primary pooling event), we note that we expect money held by the firm to be paid back to the lenders after a primary pooling event, who we are treating as the clients under CASS 7A.

Q10: If contracts do not provide for risk transfer in the way described above, should CASS include a rule to require this in order to protect borrowers?

3.26 If there is a primary pooling event, in the CP we said that we do not envisage that any repayments will need to be made to borrowers after they have paid money to the platform that has not yet been paid to investors. This is because we think that there may be risk transfer in the contracts, which is to say that the borrower's obligation to make a repayment is discharged under the contract when the borrower makes a payment to the platform.

3.27 We received 29 responses on this point. 22 respondents agreed with the proposal.

3.28 Three respondents suggested that a rule could set out a default position (for risk transfer) but allow an alternative if, for example, the loan contract stipulates that the borrower is at risk and not the investor. Two respondents disagreed with the need for a new rule, thinking it unnecessary.

3.29 One respondent noted that, where an alternative service provider is used, the question of risk transfer would depend on the specific option, but the customers could still agree that risk is transferred when either an entity with client money permission or a payment/e-money institution is paid.

Our response

Given the responses to the consultation, we are proposing to maintain our position that client money is held for the lenders, and that on insolvency client money will be distributed to the lenders. We may review the rules in due course to assess if any change is necessary.

Q11: Do you agree with our understanding of how money received after a primary pooling event will be treated?

3.30 In summary, the CP said that money received after a primary pooling event should not be pooled with the money held prior to the pooling event, and should be held in accordance with CASS and paid to the relevant investor without delay.

3.31 There were 27 responses to this question and all but one agreed with the approach set out. One respondent suggested that we provide further guidance in respect of scenarios in which another firm steps in to administer the loan book. Another suggested that the responsibility for returning money to investors should fall to the entity that administers existing loans in the event of platform failure.

Our response

We note significant support for this proposal. We do not consider that it would be helpful to provide guidance in respect of prospective situations where another firm might step in to administer loans because this will depend on the individual circumstance of each situation and the rules cannot consider every eventuality. We feel that, broadly, we have explained how we expect monies to be returned by an insolvency practitioner under the CASS rules.

While we have consulted on requiring firms to make arrangements for another party to administer loans in the event of their failure, we feel that an insolvency practitioner should return money already held by the firm to clients in the event of insolvency. This is especially relevant where the firm in question carries out other types of business covered by CASS 7, since all the client money held by the firm will be pooled.

We expect that an insolvency practitioner would wish to make arrangements under CASS 7A for a new account to be set up as soon as is practicable, to treat client money received after failure in accordance with the rules, and to return this money to the clients (the lenders) as explained in CP13/13.

Protections in the event of failure of the firm running the platform

Q12: Do you agree that firms operating loan-based crowdfunding platforms should be required to have arrangements in place so that existing loans continue to be administered in the event of platform failure?

3.32 If the firm operating a platform fails, to avoid difficulty for investors, existing loans must still be administered. With some platforms, investors do not know the identity of the borrowers they have lent money to and an investor's stake in a particular loan may be small, so it may not be economic to chase missing payments. These factors may encourage borrowers to default on loans leading to investor losses. So we proposed to require that firms have arrangements in place to ensure that loans continue to be administered if the firm running the platform goes out of business.

3.33 Most of the respondents who commented on this proposal were in favour of a requirement for firms to have such arrangements.

3.34 A number of respondents suggested that this should be a key area of focus for both firms and FCA supervisors, to test the robustness of these arrangements and to disclose the arrangements to consumers.

3.35 Some respondents asked what would happen if the third-party firm also failed leaving no arrangements in place to administer loans. One suggested that the FSCS should be available in this instance. Another felt that the arrangements that are put in place might not work in practice, so it would be preferable to increase the capital requirements to cover the risk of platforms ceasing to operate. Others recommended more prescriptive requirements, such as mandatory governance systems, specifying the type of third party that could act in this role, or standardised processes in firms to make certain that the arrangements are robust.

3.36 Two respondents felt that, while a sensible step, these arrangements should be a commercial decision for firms as it could carry a significant cost. Others warned against one-size-fits-all requirements and recommended that firms should have greater choice over the type of arrangements they have in place, beyond the examples given in the CP.

Our response

We are introducing a rule to require firms running loan-based crowdfunding platforms to take reasonable steps to have arrangements in place to ensure loan agreements facilitated on the platform will continue to be managed and administered in accordance with the contract terms, if the firm ceases to carry on the regulated activity in relation to lending.

In order to create a proportionate framework that balances regulatory costs against benefits, we are not at this time setting prescriptive requirements for the arrangements that firms must introduce. Instead, we expect firms to design systems and controls that are appropriate to the needs of their business model and consumers.

We agree with respondents who noted that these arrangements must be robust and we expect firms to take particular care in their design.

As some noted, even with these arrangements in place, it is impossible to remove all risk and there is still the possibility of consumer detriment if arrangements fail to work as expected. We expect these risks to be made clear to investors. We do not consider it desirable to try to remove all risk, however: it would be prohibitively expensive and probably impossible to do so.

Cancellation rights

Q13: Do you agree with our interpretation of the Distance Marketing Directive cancellation rights for firms operating loan-based crowdfunding platforms?

3.37 The Distance Marketing Directive (DMD) requires that most financial services contracts made at a distance (without the simultaneous physical presence of the supplier or intermediary and the customer) give customers the right to cancellation within a set period, without penalty and without giving a reason.

3.38 There is no right, however, to cancel distance contracts for investments whose price depends on fluctuations in the financial market that are outside the firm's control. In the CP, we suggested that this means that, where a platform includes a secondary market, the DMD cancellation rights are not required.

3.39 Most respondents who addressed this issue agreed with our interpretation. A number of reasons were given by those who disagreed.

- Platform operators only act as intermediaries between investors and borrowers, so they should not be responsible for the cancellation rights and will not be in a position to cancel contracts that have already been agreed.
- There are two contracts to consider, and they may not actually qualify as distance contracts in some cases.
  - The first is the service agreement that is entered into by the platform operator with all users of its platform, whether they are borrowers/ fundraisers or lenders/ investors.
  - The second is the loan or subscription agreement entered into directly between the borrowers/ fundraisers or lenders/ investors, to which the platform operator is not a party.

  The relevant EU legislation for these contracts provide that the right to cancel is lost in relation to a distance contract for services if the performance of the contract has begun with the consumer's agreement.
- One respondent noted that the existence of a secondary market does not, on its own, ensure liquidity for investors, and the value of the investment may not fluctuate during the cancellation period.
- One respondent argued that the cancellation rights should apply to each loan, rather than to registration on the platform as we suggested in the CP.

Our response

The cancellation rights are created by EU legislation and already apply to firms running loan-based crowdfunding platforms. Our CP does not change these requirements and there is no national discretion to dis-apply them. That said, cancellation rights do not apply in certain situations and it is for firms to consider whether they need to grant cancellation rights to investors.

Where firms are required to offer cancellation rights, we consider that the most practical approach is for the right to cancel to attach to the initial agreement with the platform, rather than to each loan contract. We are not mandating how firms provide these rights.

Where a secondary market exists in name only but does not work in practice – that is, if no trades take place and the investment does not fluctuate in value – we question whether the criteria are met for the business model to be exempt from the requirement to offer cancellation rights.

Disclosure rules

Q14: Do you have any comments on our proposed approach to regulating disclosures on loan-based crowdfunding platforms?

3.40 While we consulted on a number of other investor protections, the regime we proposed is primarily a disclosure-based regime. Our rules will require firms to ensure that investors have the information they need to be able to make informed investment decisions and that all communications are fair, clear and not misleading.

3.41 In the CP we set out some concerns with existing disclosure practices and summarised the type of information we expect to see disclosed about the firms and their services. This includes, for example, the disclosure of expected and actual default rates, investment security mechanisms, comparative information and periodic reporting to clients.

3.42 We received 29 responses on the proposed approach to disclosures. One respondent disagreed with the need for regulation of disclosures from 1 April, on the basis that investors in this market make use of other sources of information, such as social media, rather than regulated disclosure.

3.43 One respondent suggested that we should require a specific disclosure document for firms that facilitate loans to small businesses, particularly where investors are lending money to specific businesses. The respondent argued that investors buying debt securities in public limited companies benefit from additional protections and disclosure requirements that are missing from our proposals.

3.44 Several specific issues were raised by respondents in relation to disclosure standards:

- A number of responses argued that loans are not controlled investments within the meaning of the Financial Promotion Order so loan-based crowdfunding websites and details of specific loans listed on them do not amount to financial promotions. Similarly, it was suggested that loan agreements should not be included in the FCA handbook definition for designated investments.

- Some respondents welcomed the high-level rules approach we proposed, under which we do not prescribe specific disclosures that must be made. Others, however, called for the FCA to introduce a template of disclosures to reduce costs for firms. They suggested that we:

  - set the criteria by which a loan should be regarded as being in default, rather than allowing firms to develop their own approach

  - require disclosure of statistics in relation to loans in late payment or default

  - require examples of returns in different scenarios (such as good, bad and worst-case scenarios)

  - prescribe standardised risk ratings for loan classification

  - set minimum standards of due diligence that must be conducted and disclosed when firms assess the creditworthiness of loans

- require firms to disclose information on how their platform model works
- ban the use of words that imply greater capital security than really exists (e.g. the use of terms such as 'guaranteed', 'protected', 'safe' or 'secure)
- ban comparisons with deposit accounts in communications to investors and potential investors.

- Some respondents argued that it is not appropriate for platforms to set out how taxation is calculated for investors and the amount of tax owed by each investor; with one noting that they suspect most retail investors do not bother to declare their taxable income, especially if they do not submit a Self-Assessment form.
- Of the respondents who mentioned the periodic reporting requirements, most agreed with them but one suggested that the nature of the platforms facilitates real-time valuations and annual statements are unnecessary.
- Two respondents cautioned against requiring too much information to be disclosed as key information may be lost or investors put off reading it.

Our response

We believe the high-level rules on which we consulted are proportionate for this market at this time. We do not consider it appropriate to mandate specific disclosures or the form and content of those disclosures since business models vary across the market. Instead, the rules require firms to consider the nature and risks of the investment, and the information needs of their customers, and then to disclose relevant, accurate information to them. The high-level approach puts the onus on firms to provide appropriate, useful information, and not to over-burden consumers with too much detail.

Although we do not require specific types of information, where relevant to the needs of an investor on a particular platform, the examples cited by respondents will need to be disclosed. For example, firms will need to provide appropriate information about their business model and the way in which loans are assessed as being in late payment or default.

We do not propose to ban specific terms or disclosure practices. However, firms may only use terms, such as 'protected' or 'secure', or make comparisons of returns to savings accounts, where that is fair, clear and not misleading.

The Regulated Activities Order and Financial Promotion Order have been amended to include Article 36H agreements within the scope of our rules; so the websites and details of loans will be considered to be financial promotions subject to our rules.

Regarding taxation, we expect firms to provide sufficient explanation of the position so customers can understand their tax obligations. The explanations should enable the investor to perform their own calculations and compare net returns with those of other investments.

Dispute resolution and access to the Financial Ombudsman Service

Q15: Do you agree that firms running loan-based crowdfunding platforms should be subject to our dispute resolution rules?

3.45 We proposed that investors who are unhappy with the service they receive from a firm should have the right to complain. In the first instance, they should complain to the firm running the platform and, if unhappy with the response, they should be able to take the complaint to the Financial Ombudsman Service.

3.46 A total of 36 respondents commented on this proposal, with all agreeing that firms should be subject to dispute resolution requirements. Some of the responses included additional observations, as follows:

- One noted that the industry is still small so this may have an impact on the processes firms adopt or lead to disproportionate costs.
- Some asked for further clarity on what constitutes a complaint for these purposes.

Our response

Following consideration of this feedback, we are introducing rules to give investors the right to complain, first to the firm and then, if relevant, to the Financial Ombudsman Service.[11]

The rules for dispute resolution do not mandate specific processes, so long as complaints are dealt with fairly and promptly. We expect firms to develop processes that are appropriate for their business models, and do not expect them to lead to disproportionate cost.

The definition of a complaint in our Handbook is deliberately broad. It includes 'any oral or written expression of dissatisfaction, whether justified or not, from, or on behalf of, a person about the provision of, or failure to provide, a financial service or a redress determination, which alleges that the complainant has suffered (or may suffer) financial loss, material distress or material inconvenience'.

FCA reporting requirements

Q16: Do you have any comments on the reporting requirements we propose for firms running loan-based crowdfunding platforms?

3.47 To help us monitor the market we proposed that firms should submit regular reports to us, concerning:

- their financial position

11 See Annex K of Appendix 2 of PS14/3, *Detailed rules for the FCA regime for consumer credit*, February 2014, for DISP 2.7.6R(15)

- client money held
- complaints,
- details of loans arranged each quarter.

3.48 We received 27 responses to the question on reporting requirements. Ten agreed in full with the proposals and ten others agreed, subject to the following observations:

- Three respondents suggested further data that should be collected to help monitor the market, including, for example:
  - the report should specify what is meant by the default rate to ensure consistent reporting
  - instead of asking for mean values, the report should gather data on medians, maximums and, perhaps, quartiles
  - we should gather additional information on:
    - the basic platform fees, and
    - the range of costs incurred by users of the platform.
- Two respondents agreed with the content but felt that we should monitor these issues in real time rather than via regular reports that are submitted by the firms.

3.49 Some responses expressed a concern that the regular reports would add disproportionate costs to firms running loan-based crowdfunding platforms. Two felt that the costs would be higher than estimated in the CP because these firms lack regulatory experience.

3.50 Three respondents asked for further clarity on when the reporting requirements come into force.

Our response

We are introducing rules that implement regular reporting requirements for firms running loan-based crowdfunding platforms. We believe this information is appropriate and proportionate, and the benefits of providing it will outweigh the costs. We consider that the requirement to submit information on the basis outlined, via our online reporting system, GABRIEL, would be less costly than mandating real time access for the FCA to information in a prescribed format.

The data will be gathered using a combination of new and existing forms:

- prudential and financial position: prudential data will be gathered using a new form, FIN069, as set out in Appendix 1 of this paper, and financial data on a firm's balance sheet and profits and losses will be collected using existing forms (FSA029 and FSA030)
- notification of change in total value of loans outstanding of 25% or more: this data should be submitted by email

- client money position for CASS medium and large firms: the CMAR set out in SUP 16 Annex 29R
- investor complaints experience as set out in DISP 1 Annex 1R
- information on loans arranged over the previous quarter: this data will be gathered using a new form, FIN070, as set out in Appendix 1 of this paper.

These reporting requirements generally apply for all firms running loan-based crowdfunding platforms from 1 October 2014. The prudential and financial reporting returns (FSA029, FSA030 and FIN069) only apply once a firm has become fully authorised. So if a firm does not become fully authorised until December 2014 then it does not start submitting financial and prudential returns until the relevant quarter date after that. Equally, if a firm becomes fully authorised on 1 July 2014 the prudential and financial reporting returns do not commence until the relevant quarter date after 1 October 2014. See our responses to questions 6 and 8 for more discussion on our approach to the requirement for firms to report changes of more than 25% in the total value of loans outstanding and the CMAR requirement for CASS medium and large firms respectively.

We have made amendments to forms FIN069 and FIN070 from the versions on which we consulted. For FIN069, these amendments reflect the new prudential calibration.

For the reasons set out earlier we are not mandating a definition of default rates.

While mean values may not provide such detailed information as data on maximums, medians and quartiles, we do not consider it to be proportionate to require that level of detail and are seeking adequate information that will not overburden firms.

We are interested in the charging structures of platforms but this information does not need to be submitted regularly so will not be included in the regular reporting requirements.

4. Investment-based crowdfunding (and the promotion of non-readily realisable securities)

4.1 This chapter summarises feedback received to proposals outlined in chapter 4 of CP13/13. It also explains minor amendments to our policy and provides further comment on the rationale for our approach.

4.2 In the CP we proposed amendments to the rules that apply to firms operating investment-based crowdfunding platforms, and other firms with non-internet-based businesses that market unlisted equities and debt securities.

4.3 Our intention is for a fair, proportionate, media-neutral regulation, detailed in the FCA Handbook, that will apply in the same way to all competing firms, whether directly authorised or an appointed representative of an authorised firm, and whether using the internet or other media to communicate with their clients. We also want less need for the FCA to routinely apply individual restrictions to the permissions of authorised firms operating investment-based crowdfunding platforms.

4.4 Our proposed approach aimed to provide ordinary retail investors, who may lack the knowledge, experience and resources to understand and cope with the risks, with both the freedom to invest and proportionate protection when they are invited to invest in non-readily realisable securities that involve potential for significant capital losses.

4.5 We also wanted clarity for the businesses and individuals seeking to raise finance from the general public by selling unlisted equity and debt securities.

Overview and clarification of proposals

4.6 To ensure a more sustainable regime and limit potential for consumer detriment, we proposed amending our rules. The key proposal was to restrict the type of investor to whom firms can send direct offer promotions for unlisted equity or debt securities. We also proposed, where no advice was provided, that all firms (MiFID and non-MiFID) must check that clients have the knowledge and experience needed to understand the risks involved before being invited to respond to an offer.

4.7 The proposed rules required firms promoting unlisted securities via crowdfunding platforms (or other media) to communicate direct offer financial promotions only to certain types of investor. These are:

- professional clients; or

- retail clients who confirm that, in relation to the investment promoted, they will receive regulated investment advice or investment management services from an authorised person; or
- retail clients who are venture capital contacts or corporate finance contacts; or
- retail clients who are certified or self-certify as sophisticated investors; or
- retail clients who are certified as high net worth investors; or
- retail clients who certify that they will not invest more than 10% of their net investible financial assets in unlisted equity and debt securities (i.e. they certify that they will only invest money that does not affect their primary residence, pensions and life cover).

4.8 Where advice is not provided, we proposed that all firms would apply an appropriateness test, in line with the rules in COBS 10, before sending retail clients direct offer financial promotions for unlisted securities. This was to help ensure that only clients who have the knowledge or experience to understand the risks would invest.

Q17: Do you agree with our proposals to revise our approach to investment-based crowdfunding platforms?

Summary of responses

4.9 Responses have been varied. Some respondents considered the proposals too restrictive and argued that the FCA should provide for a more limited approach to regulation in this sector in order to encourage innovation and competition in the market. Other respondents argued that we had underestimated the risks involved when investors buy unlisted securities. They noted a lack of quality in the due diligence provided for investors to consider, and the limited ability that minority shareholders will have to influence the future of the companies they invest in.

4.10 However, most respondents welcomed our proposals, often arguing that regulation was needed to both protect consumers and increase consumer trust in the sector. No one disagreed with our assessment of the significant risk of failure applying to the start-up companies that might seek access to finance. The few responses we received from retail investors themselves made it clear that regulation of this market was welcome.

Restricting direct offer financial promotions for 'non-readily realisable securities'

4.11 In CP13/13 we proposed marketing restrictions that would apply to firms when they promote 'unlisted shares' or 'unlisted debt securities'. Having received queries asking us to clarify exactly what we meant by these terms, we realise that this terminology does not adequately describe the hard-to-price, illiquid securities we meant to describe.

Our response

An aim of our proposals was to mitigate the liquidity risk investors face when investing in the equity or debt securities of small and medium enterprises which are difficult to price and for which there is no, or only a limited, secondary market. We did not intend to restrict the promotion of securities that are traded on a recognised investment exchange such as AIM.

We would like to clarify that we consider liquidity risk to be mitigated if securities are:

- admitted or about to be admitted to an official listing; or
- traded, or soon to be traded, on a recognised investment exchange or designated investment exchange,[12]

as then there is an acceptable secondary market and the securities are 'readily realisable'. We do not think liquidity risk is adequately mitigated by an online bulletin board on which people can list securities they wish to sell.

To better describe the illiquid shares and debentures we intended this proposal to cover, we have amended the text by replacing 'unlisted share and unlisted debt security' with a new defined term for 'non-readily realisable security'. This term will apply to securities that are not 'readily realisable securities', 'packaged products' or 'non-mainstream pooled investments'.

An established regime already applies to packaged products, and legislative and regulatory marketing restrictions already apply to promotions for non-mainstream pooled investments (NMPIs), including unregulated collective investment schemes (UCISs). Therefore, there is no need for the definition for non-readily realisable securities to include such products.[13]

Restricting direct offer financial promotions (not all promotions)

4.12 A few respondents thought that the restrictions would apply to all their financial promotions.

Our response

The restrictions only apply to direct offer financial promotions.[14] To be a direct offer the promotion needs to contain an offer or invitation, and specify the manner of response or include a form by which a response may be made. So, if a promotion does not specify how to respond, then that promotion is

12 A 'recognised investment exchange' is an investment exchange declared by a recognition order made under section 290 or 292 of FSMA 2000. A 'designated investment exchange' is one of the overseas investment exchanges listed in the FCA Glossary under this defined term.

13 See COBS 4.12

14 *A direct offer financial promotion* is one that contains: (a) an offer by the *firm* or another person to enter into a *controlled agreement* with any *person* who responds to the communication; or (b) an invitation to any person 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.

not caught by the restriction. For example, if a communication simply gives marketing information about the firm operating the platform or information about who can be invited to invest, then the marketing restriction will not apply to it. Whereas if it gives marketing information about a specified investment opportunity, the restriction will apply. As usual, unless an exemption applies, firms will need to ensure promotions comply with the other relevant financial promotion rules. If subsequent promotions in the communication chain are direct offer financial promotions these will be subject to the restrictions.

Differing investment risks

4.13 Some respondents stated that the risks inherent in an investment will vary depending on the underlying assets and, for this reason, disagreed with the application of the same restrictions to the promotion of all illiquid equity and debt securities. They argued that securities that are secured or asset-backed (for example by real estate or renewable energy installations), or are issued by more established companies, have lower risk than start-up businesses launching unproven technology or new business ideas.

4.14 Other respondents argued that achieving a positive return when investing in unlisted securities would be unlikely, and would take much longer than many new investors are likely to expect.

Our response

We agree that different securities will be issued on different terms and have different inherent risks. We also agree that it is difficult for ordinary retail investors, who are not receiving advice, to assess the value of an investment and likelihood of investment returns if they do not have access to reliable due diligence information about the securities they are offered. So, even when secured, asset-backed or issued by a more established company, we take the view that investors face significant risks when buying a non-readily realisable security. These include the risk of capital loss (which is exacerbated if the price paid for a security is based on an over-valuation of the business or if the security is a long-term debt security that will not return capital for periods such as 20-25 years), the risk of dilution of shareholder value, the risk that dividends will not be declared, and illiquidity risk. We do not propose to draw distinctions between the different types of non-readily realisable security.

Distinguishing between P2P agreements, unlisted debt securities and unlisted equity

4.15 In chapter 3 of CP13/13 we consulted on the approach we plan to apply to the marketing and selling of 'P2P agreements' (specified investments that are loan agreements in accordance with article 36H of the Regulated Activities Order (RAO)). In chapter 4 of CP13/13 we consulted on a more restrictive regime for unlisted equity and unlisted debt securities (such as debentures that are a specified investments under article 77 of the RAO) that would provide consumers with more protection.

4.16 Some respondents questioned our approach. Some noted that there are differences between the equity and debt securities issued by companies, and suggested that we treat them differently. They also noted similarities between debt securities and article 36H loan agreements which they suggested should be treated alike.

Our response

We agree with some of the observations made. However, we see sufficient similarities between the equity and debt securities issued by companies, and sufficient distinctions between debt securities and article 36H loan agreements, to justify the different approaches proposed.

From our analysis of the market, we consider the longer-term, illiquid unlisted debt securities offered by companies to carry more risk of capital loss for investors than short-term P2P agreements. Although some are more established, many of the companies offering unlisted equity or debt securities are early-stage companies and, as explained in chapter 2 of the CP, research indicates that around 50% to 70% of early-stage businesses fail. No respondents disagreed with this analysis, and some considered it an underestimation.

We consider it appropriate to assume that non-readily realisable equity and debt securities issued by companies will involve risk of capital losses. In contrast, P2P loan agreements often involve lending to individuals rather than companies, are usually re-paid over three to five years, and currently have low default rates. So at present, in the P2P loan market, we consider it reasonable to assume a lower risk of significant capital losses, and less need for consumer protection measures.

We are also aware of the information and bargaining asymmetries that apply. Companies issuing unlisted debt securities are free to set the terms of the securities they issue, to suit themselves. For example, some firms issuing non-readily realisable, illiquid debt securities not only deny investors the opportunity to trade them on a recognised investment market, but also make them non-transferable. In contrast, a company or individual borrowing money under a P2P loan agreement facilitated through a loan-based crowdfunding platform usually does so under terms which they do not control. Furthermore, individuals investing in the peer-to-peer or peer-to-business loan market can usually lower their overall risks by diversifying their investments more easily than investors in securities can.

We propose to maintain the distinction between P2P loan agreements and non-readily realisable securities for the time being. If the market changes in the future so the risks of investing in loan-based crowdfunding come to resemble those currently seen in debt securities in the investment-based crowdfunding market, we may need to review our stance and consult on the introduction of further consumer protection rules for some loan-based crowdfunding platforms.

Our media-neutral approach

4.17 Our proposals reflect the rise of the popularity of internet-based crowdfunding. We consider this market to have arisen, in part, as a result of enhancements in digital technology. These have reduced marketing, distribution and transactional costs by providing standardised and automated processes.

4.18 However, in line with our high-level policy, the proposals we consulted on were media-neutral, and intended to apply to all firms marketing and selling non-readily realisable securities in the UK, whether over the internet or through other media. This was done with our competition objective in mind and in order to provide appropriate protection for all investors however they invest.

4.19 Some respondents, concerned with the promotion of unlisted debt securities (mini-bonds), using offline media suggested that the proposals need not apply to this activity.

Our response

The CP referred to crowdfunding and similar activities and, in Chapter 1, made it clear that it applied to any firm that, using any media, communicates direct offer financial promotions for unlisted equity or debt securities to retail clients who do not receive regulated advice.

In our view, the same protection should apply to investors whether they engage with firms online or offline as a result of direct marketing or through telephone-selling of investments. Therefore, we do not propose to alter the applicability of the rules proposed.

Other relevant legislative provisions (in the Financial Services and Markets Act, Prospectus Directive and Companies Act) and administrative responsibilities

4.20 Some respondents queried how our proposed rules interact with the legal requirements and restrictions outlined in sections 755 and 756 the Companies Act 2006, section 85 of FSMA, the Prospectus Directive, the prospectus rules and the listing rules.

Our response

The rules we consulted on do not affect or limit the applicability of existing legislation. Companies seeking to raise finance by issuing equity or debt securities are responsible for complying with all relevant legislation, including the Companies Act prohibition of the public offer of private company shares.

In addition to complying with the disclosure and financial promotion requirements and restrictions in the FCA Handbook, it is for the firms operating crowdfunding platforms, and the companies seeking finance through them,

to satisfy themselves that they are meeting any requirement to publish a prospectus (or satisfy themselves that an exemption[15] is available).

In line with our Principles, we expect firms that operate investment-based crowdfunding platforms to conduct their businesses with integrity and have system and controls in place to mitigate the risk of offers being made in contravention of applicable legislation. Firms should manage conflicts of interest fairly, both between themselves and their clients, and between the clients seeking to raise finance and the clients looking to invest.

Authorised firms should also be aware of clients' right of action arising under FSMA section 138D.

Risk warnings

4.21 Several respondents suggested that, instead of the approach we proposed, appropriate consumer protection could be provided by an FCA-approved risk warning that investors could confirm they have read before investing.

Our response

Fair, clear and prominent risk warnings that take into account the nature of the product, the risks involved and the client's commitment, are already required.[16] However, we do not think risk warnings on their own provide adequate consumer protection for retail clients who are offered risky and complex non-readily realisable investments.

As the risks involved when investing in different non-readily realisable securities vary greatly, depending on the nature of the investment offered, it may not always be meaningful or helpful to present consumers with a single, uniform FCA-approved risk warning. Different warnings will be needed in differing circumstances, for different investments and audiences.

Disclosure, due diligence requirements relating to investee companies, and lack of recourse to the FSCS

4.22 Some respondents asked for guidance to explain in more detail what the disclosure requirements and due diligence requirements are in relation to the offers made by investee companies.

15 Exemptions are available in relation to promotions for small securities issues. If the total consideration for securities offered does not exceed 100,000 Euros (or equivalent amount) FSMA s86 may provide an exemption to FSMA s85. If offers fall below the €5 million limit, they may be exempt from the need for a prospectus under the Prospectus Directive. In relation to business that is not MiFID business, due to the exemption in the FPO article 70, the FSMA s21 financial promotion restriction does not apply to any communication that is included in listing particulars, supplementary listing particulars, a prospectus, or a supplementary prospectus or any other document required or permitted to be published by the listing rules or the prospectus rules. In relation to business that is MiFID business, exemptions are available for third party prospectuses.

16 See COBS 4.5.2R(2) and COBS 4.5.4G.

Our response

The financial promotion and disclosure rules continue to apply. Firms that communicate or approve financial promotions will need to ensure that they comply with the rules, particularly the requirement for the promotion to be fair, clear and not misleading.

We expect firms to take account of the needs of recipients and give sufficient emphasis to the extent to which an investment places a client's capital at risk. Accurate, sufficient information is required; so we expect firms to include information about the lack of a secondary market and, where compensation scheme arrangements are mentioned, information about the lack of recourse to the FSCS.

In satisfying the financial promotion rules we expect sufficient detail to be provided to give a balanced indication of the benefits and the risk involved, including whether or not any due diligence has been carried out on an investee company, the extent of the due diligence, and the outcome of any analysis.

When offers are made in relation to an Enterprise Investment Scheme (EIS) company or EIS fund (or Seed EIS company or Seed EIS fund) offering we would also expect firms to make it clear that the tax treatment depends on the individual circumstances of each client and may be subject to change in future.

Advised and non-advised sales

4.23 A few respondents objected to the application of the appropriateness test provisions. Some suggested that these should only apply when there is a client relationship between the firm communicating the promotion and the investor.

4.24 Most respondents accepted that when clients receive advice the suitability rules in COBS 9 apply, and they did not object to our proposal that no promotion restriction was needed when advice is given.[17] They also accepted that carrying out due diligence assessments, and explaining the extent of these, does not by itself amount to making a personal recommendation or giving advice.

Our response

When firms communicate financial promotions to investors our rules require that they are considered 'clients' of the firm.[18] Further, in line with MiFID provisions, before arranging deals in certain complex financial instruments for retail clients who do not receive advice, firms are required to assess whether the client has the necessary experience and knowledge to understand the risk involved. The proposed rule allows this to be carried out either by the firm which promotes the investment or by the firm arranging the sale, and either before promotion or before sale. We expect firms to be able to apply these assessments as part of an

17 As detailed in COBS 4.7.8R.

18 See COBS 3.2.1R(3).

online registration process with a crowdfunding website. We can also confirm that repeat appropriateness assessments will not be required if it is reasonable to consider that an earlier assessment is still current.

Other comments and clarification

4.25 Some respondents queried how, in practice, the restriction might apply to 'restricted investors' (retail clients who certify that they will not invest more than 10% of their net investible assets in non-readily realisable securities).

4.26 Some respondents suggested that the restrictions proposed should apply pre-sale rather than pre-promotion, or only to transactions below a certain financial limit such as £500 or £5,000 per annum.

4.27 Some asked whether the client certification and appropriateness test requirements could be integrated.

4.28 Some thought we had under-estimated the risks involved when investing in unlisted securities, noting that there had been no substantive exits from crowdfunded enterprises, and the risk of capital loss may be greater than assumed. In contrast, others argued that we had over-estimated the risks, and suggested that investments designed to have a social impact should be viewed as less of a concern. Others suggested that blog-based exchanges between investors provided useful information on offers for potential investors that mitigated risks.

Our response

We can confirm that if an individual signs a Restricted Investor Statement, then firms can communicate direct offer financial promotions for non-readily realisable securities to that individual for 12 months after the date of the statement.

Firms need to satisfy themselves that there is a valid statement in place at the time of communicating the promotion, but do not need to ensure that individuals who subsequently invest continue to qualify as 'restricted investors' on an ongoing basis.

We did not consult on pre-sale restrictions and took the view that it was not appropriate to apply lower standards when consumers invest more modest sums of money.

Firms can integrate the client certification and appropriateness test requirements if they wish. However, to be compliant, it would need to be a pre-promotion process.

We consider different offers to involve different risks, which need to be explained in a fair, clear and not misleading way. We also consider the firm promoting the investment, rather than unauthorised bloggers, to be responsible for ensuring that fair, accurate, balanced and sufficient information is provided to investors.

5.
Market information, cost benefit analysis and compatibility statement

5.1 The CP provided a summary of the market affected by our proposals, summarised our analysis of market failures and the costs and benefits of our proposed rules and explained how our approach is compatible with the FCA's statutory objectives. This chapter summarises the feedback received on these points.

> ***Q18:** Do you have any comments on our analysis of the crowdfunding market or further information about it?*

5.2 In Annex 1 of the CP, we set out a description of the market and asked respondents whether they agreed with this summary or have any further information about it.

5.3 28 respondents commented on our analysis making a number of observations.

5.4 Further information on the UK crowdfunding market was supplied by reference to a report published in December 2013 by Nesta, the University of California, Berkeley, and Cambridge University.[19] Of particular interest is the report's estimate that, in terms of regulated crowdfunding models:

- loan-based crowdfunding platforms raised £480m in 2013, of which:
  - £287m was loaned to individuals, an increase of 126% compared to 2012
  - £193m to businesses, an increase of 211% compared to 2012, and
- investment-based crowdfunding platforms raised £28m in 2013, an increase of 618% compared to 2012.

5.5 These figures broadly support the estimated market size in 2012, as reported in the CP.

5.6 A few respondents noted that the market is evolving rapidly and it is not possible to know what direction it will take in the future. The effect of regulation may lead to some consolidation or may support its growth.

5.7 One respondent noted that it is necessary to regulate these markets even though some people may perceive the proposed regulation to be excessive; the dangers of too little regulation would be significant for many investors.

19 *The Rise of Future Finance, The UK Alternative Finance Benchmarking Report*, National Endowment for Science Technology and the Arts (Nesta), University of California, Berkeley, and Cambridge University, December 2013

5.8 In relation to loan-based crowdfunding, some respondents called for more prescriptive requirements for transparency. One, for example, called for rules on insider trading to prevent employees in firms running loan-based crowdfunding platforms, who engage in their own investment on the platform, from selling loans on the secondary market based on early access to information about a possible default or payment difficulties. This respondent noted that they have seen some loan parts sold very shortly before a payment has been missed by the borrower. They suggested that greater transparency around the identity of all investors on the platform would help to deal with this issue.

5.9 In terms of investment-based crowdfunding, to help the market grow, one respondent suggested that the FCA introduce rules to make it easier for independent financial advisers (IFAs) to give advice on unlisted securities. For example, individuals who meet the restricted investor certification requirement could be eligible to receive product specific advice without the need for the IFA to undertake a full suitability appraisal.

5.10 In relation to equity-based crowdfunding, one respondent said that the assessment of risks in the CP is inadequate. They consider that achieving a positive return would appear to be much less likely and take much longer than many new investors would expect. Therefore, mandatory due diligence is necessary and more information on success and failure rates should be published.

5.11 Some respondents made arguments against the proposed regulatory approach or, indeed, the need to regulate crowdfunding at all. These arguments included the following points:

- Crowdfunding will facilitate citizen shareholding and provide an alternative source of finance for business. Investors play an active role in supporting business development and many understand the investment to a greater degree than they understand more mainstream financial products, like personal pensions.

- There are many different reasons behind the decision to invest in businesses via crowdfunding platforms. These reasons include an emotional as well as a rational connection with the project in which they invest. Investors may use this emotional connection to offset their more rational responses and, as a result, accept a less than perfect outcome. This point was made, in particular, by one respondent concerned that charity finance and social investment models are emerging that make use of debt securities, where the respondent felt that investors are willing to invest for reasons other than financial return.

- It was also suggested that a sizeable portion of the businesses affected by these regulations are not actually aware that this is the case. Their concern is that retail bond issuers and firms that market them were not aware that these products were within scope of the consultation. Other responses suggested that regulatory uncertainty has contributed to the smaller size of the investment-based crowdfunding model, compared to other crowdfunding models.

Our response:

We consider the rules we are making in this paper to be proportionate to the risks in this market and the needs of consumers. While some respondents are concerned that they go too far, others support the need for them. We acknowledge that crowdfunding may be beneficial and act as an alternative source of finance (though at present it provides only a relatively small amount of funding) but believe it is still necessary to protect the investors who engage in it.

The rules on conflicts of interest in our Senior Management Arrangements, Systems and Controls handbook (SYSC) already address the issue of insider dealing. These rules will apply to all firms running loan-based crowdfunding platforms from 1 April 2014 and already apply to firms running investment-based platforms. They require firms to identify possible conflicts of interest that may entail a material risk of damage to the interests, to keep a record of these possible conflicts and to take all reasonable steps to avoid the conflict leading to loss for clients. Where that risk cannot be managed, it should be disclosed to clients. We would expect these arrangements to deal with the risk of insider dealing.

It was always our intention that the proposals applying to investment-based crowdfunding and similar activities would be media-neutral. We explained in the CP that they would apply to firms marketing and selling unlisted equities and unlisted debt securities (such as mini bonds) in the UK, whether over the internet or using other media. We think the CP was sufficiently clear on this point.

We have no plans to lower the standards expected of IFAs when providing advice on crowdfunding. Indeed, since these standards are set by EU legislation, this is not an option open to us.

Q19: Do you have any comments on our cost benefit analysis for the proposed regulatory approach to crowdfunding?

5.12 FSMA, as amended by the Financial Services Act (2012), requires us to publish a cost benefit analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits' that will arise if the proposed rules are made. It also requires us to include estimates of those costs and benefits, unless these cannot reasonably be estimated or it is not reasonably practical to produce an estimate.

5.13 The CBA for our proposed regulatory approach to crowdfunding was set out in Annex 1 of the CP. We asked respondents whether they had any comments or further information to assist in this analysis. The 22 responses we received conveyed a wide range of opinions.

5.14 While some felt it is difficult to challenge the values placed on the costs and benefits in our analysis, especially given that the market is still new and evolving, others felt that the costs were understated. In particular, they noted the following points:

- The analysis in respect of the client money rules does not include the costs relating to client money audit. Also, firms sometimes find it difficult to open segregated client bank accounts.
- The cost of developing IT systems for secondary markets on loan-based platforms and the appropriateness test on investment-based platforms are likely to be higher than stated and take longer to develop. One firm, for example, suggested that the cost of hiring an agency developer for IT systems is closer to £500 per day and out-sourced administrative costs are closer to £30 per hour. Another respondent suggested that costs assigned to one individual in a firm should be considered as having a wider impact on the organisation, since more than one person is likely to be involved in complying with the rules.

- Some respondents suggested that the cost of compliance advice should be included in the analysis.
- Another argued that the proposed rules are more prescriptive than the self-regulatory approach that has been followed to date by firms running loan-based platforms, and the complexity of understanding the rules should be taken into account in the CBA.
- One respondent suggested that the Weighted Average Cost of Capital (WACC) is closer to 25% or 30% as equity investors require extremely high returns for a start-up.
- One firm running a loan-based platform reported that it costs them more to retain the services of a back-up service provider than is estimated, though they noted that other options are available.

5.15 Some respondents thought the costs of meeting regulatory requirements are likely to be difficult within the low-margin business models operated by firms, and may be passed on to clients or act as barriers to entry to new firms entering the market.

5.16 Some were concerned about indirect costs if the regulation of crowdfunding puts clients off investing in crowdfunding, or puts small and medium enterprise (including social enterprise) off accessing alternative sources of finance.

5.17 One respondent suggested that the CBA should include the costs of attaining FCA authorisation and suggested a dedicated small-firms process to reduce the cost and delay associated with market entry.

Our response:

Some respondents suggested that we had, for some proposals, underestimated the costs of our proposals.

For loan-based crowdfunding we have, in some instances, revised the cost estimates reported in CP13/13 to incorporate those provided by firms.

- One respondent suggested we needed to consider costs related to client money audit. We note that an estimate of this was provided in the original CBA (see page 52).
- Feedback suggested that the one-off costs of developing a secondary market and ongoing costs could be higher than we estimated. In the CP, we estimated the one-off cost of developing a secondary market to be £4,000, with an ongoing cost of £10,000 per annum. However, feedback suggests that one-off costs could be as much as £20,000 and ongoing costs £30,000. We note that these estimates may lead to higher costs. But, as the development of a secondary market is not required by our rules and firms can, instead, provide DMD cancellation rights, we consider our estimates to be reasonable, as they were based on market rates, and it is not necessary to revise our proposals.DMD cancellation rights are an obligation in EU legislation and we expect that firms already in the market will be complying with this requirement.

- Feedback also suggested that our estimate for the costs involved in understanding the rules and training costs from compliance professionals were underestimated. In total, we had estimated one-off costs of £8,100 per firm; we do not consider it necessary for firms to use consultants in order to comply with these rules.

- Respondents also asked whether we had considered the cost of authorisation. We note that the cost of FCA authorisation for loan-based crowdfunding platforms has already been considered in CP13/7, CP13/10 and the underlying research in the Europe Economics report.[20]

- One respondent thought that a Weighted Average Costs of Capital (WACC) of 25% or 30% would be a better reflection of the funding cost that a small start-up firm may incur in setting up their business, although no evidence was supplied to support this view. We consider the figure (net of tax and reinvestment) used in the CP (4% one-off cost and 5.25% ongoing cost), which was prepared for us by an independent consultancy and based on analysis of broadly similar, listed firms, to be a reasonable estimate. However, we note that a higher WACC could potentially occur for a smaller, unlisted firm. Nevertheless, given the cost of prudential requirements for small firms is a small proportion of the estimated ongoing compliance costs, which are in turn a small proportion of total operating costs, we expect that even if such firms faced a higher cost of capital it would not change our conclusion on the proportionality of prudential requirements in this sector.

For firms running investment-based platforms, we estimated the one-off cost of developing functionality for investment-based platforms to certify clients and conduct the appropriateness test to be £3,000, and the ongoing costs to be minimal. While we acknowledge that costs may be higher for some firms, others already comply with more onerous requirements. So, on balance, we expect the average cost per firm to be roughly as set out in the CP. We remain of the view that compliance costs are expected to be minimal for investment-based crowdfunding.

For firms operating in the loan-based crowdfunding market, even those that offer a secondary market, we do not expect the incremental cost of our rules to significantly change the analysis set out in the CP. For example, using our updated cost figures and presenting them as a proportion of annual operating are in line with those we reported in the CP (see below). As such we do not expect it will change our assessment of market impact set out in the CP on page 61:

- 4% (small firms) and 2% (large firms) for one-off costs, and

- 4% (small firms) and 3% (large firms) for annual costs.

20 *High-level proposals for an FCA regime for consumer credit*, CP13/7, March 2013, http://www.fca.org.uk/static/fca/documents/consultation-papers/fsa-cp13-07.pdf, *Detailed proposals for an FCA regime for consumer credit*, CP13/10, October 2013, http://www.fca.org.uk/static/documents/consultation-papers/cp13-10.pdf, and *A New Consumer Credit Regime: Benefits, Compliance Costs and Firm Behaviour*, Europe Economics, October 2013, http://www.europe-economics.com/publications/final_europe_economics_report_03-10-13.pdf

Respondents highlighted that firms might leave the market or be deterred from entry. This has been acknowledged in the CBA and no firm suggested that we had underestimated this possible impact or provided alternate analysis to require us to revise our market impact analysis. In addition, we noted that firms would be able to pass on all or some of the increase in costs to their customers (investors and borrowers), by changing their fees. Which set of customers will be affected depends on the relative price elasticities of demand of investors and borrowers. Based on our estimates of compliance costs, we expect the overall price impacts on platforms' customers (both investors and borrowers) to be minimal.

In relation to our client money rules, it was suggested that firms sometimes find it difficult to open segregated client bank accounts. However, we think firms should be able to achieve this.

Q20: Do you have any comments on the compatibility statement?

5.18 We are required by section 138I(2)(d) of FSMA to explain why we believe our proposed rules are compatible with our strategic objective, advance one or more of our operational objectives, and have regard to the regulatory principles in section 3B of FSMA. We are also required by section 138K(2) of FSMA to state whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons. This analysis was set out in Annex 2 of the CP.

5.19 18 respondents commented on our compatibility statement. Some agreed with our comments in the statement and many made the same points as discussed above.

- Some respondents argued that consumers are not protected by provisions that restrict retail access to the market, noting that access to gambling is not restricted in the same manner. One observed that we have not placed sufficient focus on the general principle that consumers should take responsibilities for their decisions.
- A few felt that the benefits to the wider economy, in terms of providing a source of finance to small and medium enterprise, had not been take sufficiently into account.
- Some suggested the proposed approach to regulation will have a significant impact on the market and may kill it completely if it is too heavy handed, or favour the larger, existing players making it harder for new entrants to emerge.
- Two responses commented again on the prudential requirements proposed for firms running loan-based crowdfunding platforms, suggesting these requirements are likely to act as barriers to entry and limit the number of new entrants to the market.
- Two more argued that the special needs of platforms that raise finance for charitable or social enterprise have not been taken into account in the statement and we should do more to encourage this type of investment.
- One firm called again for additional requirements to be introduced for loan-based crowdfunding platforms.

Our response:

We believe that the compatibility statement included in the CP pays due regard to all relevant aspects, including the principle that consumers should take responsibility for their own decisions, the potential impact on the economy in terms of access to funding, and the FCA's objectives of securing an appropriate degree of consumer protection and promoting effective competition in the interests of consumers.

Where feedback made similar points to those already considered in this paper, please see earlier sections for our response.

Annex 1
List of non-confidential respondents

Abundance NRG Ltd

Adrian Oldman

Alemare Solutions Ltd

ArchOver Ltd.

Ashfords LLP

Assetz Capital

Association of Town & City Management

Bates Wells and Braithwaite London LLP

Better Capital LLP

BioIndustry Association (BIA)

Bovill Limited

Business Loan Network Ltd trading as ThinCats.com

Buzzbnk

Confederation of British Industry (CBI)

Chris Woolhouse

City of London Corporation

Clive Parritt

Creda Limited

Crowd Valley Inc

CrowdBnk Limited

Crowdcube

Crowdestates

CrowdfundRepublic

CrowdMission

Darwin Strategic Limited

David Hoare

Dr Dustin McGivern

Dr Martin Roberts

Ecology Building Society

Entrelancer Ltd

Ethex

Financial Services Consumer Panel

First Data International

Folk2Folk limited

Fredericks Foundation

Funding Circle

Funding Knight Limited

Go Beyond Early Stage Investing

Ian Gurney

Ice Dragons Ltd

IGA Ltd trading as Patronomy

Institute of Chartered Accountants in England and Wales

InvestingZone Ltd

Jackson Cohen Associates

James McNaughton

Jonathan Lea Network

Jonathan Saunders

Kession Capital Limited

Keystone Law

Killik & Co

LendInvest

London Stock Exchange Group plc

M Collins

Madiston plc trading as LendLoanInvest

Meg Hillier MP

Memery Crystal LLP

MoJoMoneyMart.com

Nelson Gray

Nesta

Nina Horstmann

Order Book for Retail Bonds Issuers Group

Peer-to-Peer Finance Association (P2PFA)

Papaverum Capital Ltd

Paper Street Funding Ltd

Perry Mayer

Peter Facey

PricewaterhouseCoopers LLP

RateSetter

RebuildingSociety.com

Rob Murray Brown

Seedrs Limited

ShareSoc UK Individual Shareholders Society

Social Finance Ltd

Social Investment Business Group

Social Investment Forum

Squareknot Limited

Stephen Hazell-Smith

Syndicate Room Ltd

Syntomy

The Finance Innovation Lab

The Social Foundation

Third Sector Finance CIC CDFI

Triodos Bank

Twintangibles

UK Business Angels Association

UK Crowdfunding Association

UK Interactive Entertainment (UKIE)

Unity Trust Bank

Veale Wasbrough Vizards LLP

Vedanvi Ltd

Waterside Gate Consulting

Wealth Management Association

Which? Ltd

Zopa

Appendix 1
Made rules (legal instrument)

CROWDFUNDING AND THE PROMOTION OF NON-READILY REALISABLE SECURITIES INSTRUMENT 2014

Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) the following sections of the Act:

(a) section 137A (FCA's general rule-making power);
(b) section 137B (FCA general rules: clients' money, right to rescind etc);
(c) section 137R (Financial promotion);
(d) section 137T (General supplementary powers); and
(e) section 139A (FCA's power to give guidance); and

(2) the other powers listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook;

B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 1 April 2014.

Amendments to the FCA Handbook

D. The modules of the FCA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Senior Management Arrangements, Systems and Controls sourcebook (SYSC)	Annex B
Interim Prudential sourcebook for Investment Businesses (IPRU(INV))	Annex C
Conduct of Business sourcebook (COBS)	Annex D
Client Assets sourcebook (CASS)	Annex E
Supervision manual (SUP)	Annex F

Citation

E. This instrument may be cited as the Crowdfunding and the Promotion of Non-Readily Realisable Securities Instrument 2014.

By order of the Board of the Financial Conduct Authority
27 February 2014

Editor's Note: This instrument takes account of the changes made in the Unregulated Collective Investment Schemes and Close Substitutes Instrument 2013 (FCA 2013/46), and proposed in the Review of the client assets regime for investment businesses (CP13/5) and the Detailed proposals for the FCA regime for consumer credit CP13/10.

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

non-readily realisable security	a *security* which is not any of the following: (a) a *readily realisable security*; (b) a *packaged product*; (c) a *non-mainstream pooled investment*.
loaned funds	(in *IPRU(INV)*) any funds that have been provided to borrowers under a *P2P agreement* through an *operator of an electronic system in relation to lending*.

Amend the following as shown.

designated investment	a *security* or a contractually-based investment (other than a *funeral plan contract* and a right to or interest in a *funeral plan contract*), that is, any of the following *investments*, specified in Part III of the *Regulated Activities Order* (Specified Investments), a *P2P agreement*, and a *long-term care insurance contract* which is a *pure protection contract*: …
designated investment business	any of the following activities, specified in Part II of the *Regulated Activities Order* (Specified Activities), which is carried on by way of business: … (db) *operating an electronic system in relation to lending* (article 36H) but only in relation to facilitating a *person* becoming a lender under a *P2P agreement* and in relation to the supplemental activities in article 36H(3)(a), (b) and (d);

…

P2P agreement

(a) (in relation to a borrower) in accordance with article 36H of the *Regulated Activities Order*, an agreement between one person ("the borrower") and another person ("the lender") by which the lender provides the borrower with credit (within the meaning of article 60L of the *Regulated Activities Order*) and in relation to which the borrower is an *individual* and either:

(a) (i) the lender provides credit (within that meaning) of less than or equal to £25,000; or

(b) (ii) the agreement is not entered into by the borrower wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the borrower.

(b) (in relation to a lender) in accordance with article 36H of the *Regulated Activities Order*, an agreement between one person ("the borrower") and another person ("the lender") by which the lender provides the borrower with credit (within the meaning of article 60L of the *Regulated Activities Order*) and in relation to which either the lender is an *individual*, or if the lender is not an *individual*, the borrower is an *individual* and either:

(i) the lender provides credit (within that meaning) of less than or equal to £25,000; or

(ii) the agreement is not entered into by the borrower wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by the borrower.

participant firm

(1) (except in *FEES* 1 and *FEES* 6) a *firm* or a *member* other than:

…

(j) … . ;

(k) … . ;

(l) an *operator of an electronic system in relation to lending* in respect of operating the system.

…

Annex B

Amendments to the Senior Management Arrangements, Systems and Controls sourcebook (SYSC)

In this Annex, underlining indicates new text and striking through indicates deleted text.

4.1.8 G …

Operators of electronic systems in relation to lending: arrangements to administer loans in the event of platform failure

4.1.8A R An *operator of an electronic system in relation to lending* must take reasonable steps to ensure that arrangements are in place to ensure that *P2P agreements* facilitated by it will continue to be managed and administered, in accordance with the contract terms, if at any time it ceases to carry on the activity of *operating an electronic system in relation to lending*.

4.1.8B R Any arrangements made under *SYSC* 4.1.8AR must be notified to lenders under *P2P agreements*:

(1) when such arrangements are made; or

(2) if later, when the lender first becomes a lender under a *P2P agreement* with that operator; or

(3) if the arrangements are changed, when that change is made; and

(4) if the arrangement involves another *firm* taking over the management and administration of *P2P agreements* if the operator ceases to *operate the electronic system in relation to lending*, the notification to lenders must inform lenders of the identity of the *firm* with which the arrangements have been made and how that *firm* will hold the lenders' *money*.

4.1.8C G Arrangements to ensure *P2P agreements* facilitated by the *firm* continue to be managed and administered may include:

(1) entering into an arrangement with another *firm* to take over the management and administration of *P2P agreements* if the operator ceases to *operate the electronic system in relation to lending*; or

(2) holding sufficient collateral in a segregated account to cover the cost of management and administration while the loan book is wound down; or

(3) entering into an arrangement for another *firm* to act as guarantor for the *P2P agreements* which includes a legally enforceable

arrangement to meet the costs of the guarantee in full; or

(4) managing the loan book in a way that ensures that income from *P2P agreements* facilitated by the *firm* is sufficient to cover the costs of managing and administering those agreements during the winding down process, taking into account the reduction of the loan pool and fee income from it.

4.1.8D G When designing its arrangements, a *firm* should take into account insolvency law to ensure that the insolvency of the *firm* does not prejudice the operation of arrangements that the *firm* has put in place.

Operators of electronic systems in relation to lending: title transfer

4.1.8E R An *operator of an electronic system in relation to lending* must not accept, take, or receive the transfer of full ownership of *money* relating to *P2P agreements*.

…

TP2: Firms other than common platform firms, insurers, managing agents and the Society

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provisions: Coming into force
…					
2.4 [FCA]	*SYSC* 4.1.8AR to 4.1.8ER and 4.1.9AR	R	The *rules* listed in column (2) do not apply to an *operator of an electronic system in relation to lending* who holds an *interim permission.*	From 1 April 2014 to 30 September 2014	1 April 2014

Annex C

Amendments to the Interim Prudential sourcebook for Investment Businesses (IPRU(INV))

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Transitional Provisions

1	**Table Transitional provisions applying to IPRU(INV)**				
(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision coming into force
…					
10	*IPRU(INV)* 12	R	*IPRU(INV)* 12 does not apply to a *firm* with an *interim permission*	Indefinitely	1 April 2014
11	*IPRU(INV)* 12.2.6R(1)	R	The amount is replaced with £20,000	From 1 April 2014 to 31 March 2017	1 April 2014
12	*IPRU(INV)* 12.3.5R	R	b = items 1,4 and 5 in the Table of items which must be deducted in arriving at a *firm's financial resources* (see *IPRU(INV)* 12.3.3 R)	From 1 April 2014 to 31 March 2017	1 April 2014

Insert the following new chapter after Chapter 11. The text is all new and is not underlined.

12 Financial resources requirements for operators of electronic systems in relation to lending.

12.1 Application and purpose

Application

12.1.1 R This chapter applies to an *operator of an electronic system in relation to lending*.

Purpose

12.1.2 G This chapter amplifies the *threshold condition* 2D (Appropriate resources) by providing that a *firm* must meet, on a continuing basis, a basic solvency requirement. This chapter also builds on *Principle* 4 which requires a *firm* to maintain adequate financial resources by setting out appropriate requirements for a *firm* according to what type of *firm* it is.

12.1.3 G Prudential standards have an important role in minimising the risk of harm to consumers by requiring a *firm* to behave prudently in monitoring and managing business and financial risks.

12.1.4 G More generally, having adequate financial resources gives the *firm* a degree of resilience and some indication to consumers of creditworthiness, substance and the commitment of its owners. The *rules* in this chapter aim to ensure that a *firm* has financial resources which can provide cover for operational and compliance failures and pay redress, as well as reducing the possibility of a shortfall in funds and providing a cushion against disruption if the *firm* ceases to trade.

Relevant accounting principles

12.1.5 R A *firm* must recognise an asset or liability, and measure its amount, in accordance with the relevant accounting principles applicable to it for the purpose of preparing its *annual financial statements* unless a *rule* requires otherwise.

Actions for damages

12.1.6 R A contravention of the *rules* in this chapter does not give rise to a right of action by a *private person* under section 138D of the *Act* (and each of those *rules* is specified under section 138D(3) of the *Act* as a provision giving rise to no such right of action).

12.2 Financial resources requirements

General solvency requirement

12.2.1 R A *firm* must at all times be able to meet its liabilities as they fall due.

General financial resource requirement

12.2.2 R A *firm* must ensure that at all times its *financial resources* are not less than its *financial resources requirement*.

Financial resources requirement: firms carrying on other regulated activities

12.2.3 R The *financial resources requirement* for a *firm* carrying on one or more *regulated activities* in addition to *operating an electronic system in relation*

to lending, is the higher of:

(1) the *financial resources requirement* which is applied by this chapter; and

(2) the financial resources or own funds requirement which is applied by another *rule* or by directly applicable legislation of the *EU* to the *firm*.

Financial resources requirement

12.2.4 R On its *accounting reference date* in each year, a *firm* must calculate:

(1) the total value of *loaned funds* outstanding on that date; and

(2) the sum of:

(a) 0.2% of the first £50 million of that total value;

(b) 0.15% of the next £200 million of that total value;

(c) 0.1% of the next £250 million of that total value; and

(d) 0.05% of any remaining total value.

12.2.5 R The total value of *loaned funds* outstanding is the total amount of funds that are currently being provided to borrowers under *P2P agreements* through an *operator of an electronic system in relation to lending*.

12.2.6 R The *financial resources requirement* for a *firm* to which this chapter applies is the higher of:

(1) £50,000; and

(2) the sum calculated in accordance with *IPRU(INV)* 12.2.4R(2) for the period until (subject to *IPRU(INV)* 12.2.9R) its next *accounting reference date*.

12.2.7 R To determine a *firm's financial resources requirement* for the period beginning on the date on which it obtains a *Part 4A permission* and ending on the day before its next *accounting reference date*, the *firm* must carry out the calculation in *IPRU(INV)* 12.2.4R(2) on the basis of the total value of *loaned funds* the *firm* projects will be outstanding on the *day* before its next *accounting reference date*.

Determining the financial resources requirement

12.2.8 G If the *firm* has 30,000 individuals each lending £100,000, the total value of the firm's *loaned funds* outstanding is £3,000,000,000. If the *firm* does not carry on any other *regulated activity* to which another higher financial resources or own funds requirement applies, its *financial resources requirement* is £1,900,000. This is calculated as follows:

(1) 0.2% x £50,000,000 = £100,000;

(2) 0.15% x £200,000,000 = £300,000;

(3) 0.1% x £250,000,000 = £250,000;

(4) 0.05% x £2,500,000,000 = £1,250,000.

Recalculating the financial resources requirement

12.2.9 R If the *firm* experiences a greater than 25% increase in the total value of *loaned funds* outstanding compared to the value used in its last *financial resources requirement* calculation, it must recalculate its *financial resources requirement* using the higher total value of *loaned funds* outstanding.

12.2.10 R A *firm* must notify the *FCA* of any change, or any likely change, in its *financial resources requirement* within 14 *days* of that change, or it becoming aware that the change is likely, whichever is the earlier.

12.3 Calculation of financial resources

12.3.1 R (1) A *firm* must at all times have available the amount and type of *financial resources* required by this chapter (see *IPRU(INV)* 12.3.2R).

(2) In arriving at its calculation of its *financial resources*, a *firm* must deduct certain items (see *IPRU(INV)* 12.3.3R).

12.3.2 R Table: Items which are eligible to contribute to the *financial resources* of a *firm*

	Item	Additional explanation	
1.	*Share* capital	This must be fully paid and may include:	
		(1)	ordinary *share* capital; or
		(2)	preference *share* capital (excluding preference *shares* redeemable by shareholders within two years).

	Item	Additional explanation		
2.	Capital other than *share* capital (for example, the capital of a *sole trader*, *partnership* or *limited liability partnership*)	The capital of a *sole trader* is the net balance on the *firm's* capital account and current account. The capital of a *partnership* is the capital made up of the *partners*':		
		(1)	capital account, that is the account:	
			(a)	into which capital contributed by the *partners* is paid; and
			(b)	from which, under the terms of the *partnership* agreement, an amount representing capital may be withdrawn by a *partner* only if:
				(i) he ceases to be a *partner* and an equal amount is transferred to another such account by his former *partners* or any *person* replacing him as their *partner*; or
				(ii) the *partnership* is otherwise dissolved or wound up; and
		(2)	current accounts according to the most recent financial statement.	
		For the purpose of the calculation of *financial resources*, in respect of a *defined benefit occupational pension scheme*:		
		(1)	a *firm* must derecognise any *defined benefit asset*;	
		(2)	a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*, provided that the election is applied consistently in respect of any one financial year.	
3.	Reserves (Note 1)	These are, subject to Note 1, the audited accumulated profits retained by the *firm* (after deduction of tax, dividends and proprietors' or *partners*' drawings) and other reserves created by appropriations of share premiums and similar realised appropriations. Reserves also include gifts of capital, for example, from a *parent undertaking*.		
		For the purposes of calculating *financial resources*, a *firm* must make the following adjustments to its reserves, where appropriate:		

	Item	Additional explanation		
		(1)	a *firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on debt instruments held, or formerly held, in the available-for-sale financial assets category;	
		(2)	a *firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;	
		(3)	in respect of a *defined benefit occupational pension scheme*:	
			(a)	a *firm* must derecognise any *defined benefit asset*;
			(b)	a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*, provided that the election is applied consistently in respect of any one financial year.
4.	Interim net profits (Note 1)	If a *firm* seeks to include interim net profits in the calculation of its *financial* resources, the profits have, subject to Note 1, to be verified by the *firm's* external auditor, net of tax, anticipated dividends or proprietors' drawings and other appropriations.		
5.	Revaluation reserves			
6.	Subordinated loans/debt	Subordinated loans/debt must be included in *financial resources* on the basis of the provisions in this chapter that apply to subordinated loans/debt.		
Note:				
1	Reserves must be audited and interim net profits, general and collective provisions must be verified by the *firm's* external auditor unless the *firm* is exempt from the provisions of Part VII of the Companies Act 1985 (section 249A (Exemptions from audit)) or, where applicable, Part 16 of the Companies Act 2006 (section 477 (Small companies: Conditions for exemption from audit)) relating to the audit of accounts.			

12.3.3 R Table: Items which must be deducted in arriving at *financial resources*

1	*Investments* in own *shares*
2	*Investments* in *subsidiaries* (Note 1)

3	Intangible assets (Note 2)
4	Interim net losses (Note 3)
5	Excess of drawings over profits for a *sole trader* or a *partnership* (Note 3)
Notes	1. *Investments* in *subsidiaries* are the full balance sheet value. 2. Intangible assets are the full balance sheet value of goodwill, capitalised development costs, brand names, trademarks and similar rights and licences. 3. The interim net losses in row 4, and the excess of drawings in row 5, are in relation to the period following the date as at which the capital resources are being computed.

Subordinated loans/debt

12.3.4 R A subordinated loan/debt must not form part of the *financial resources* of the *firm* unless it meets the following conditions:

(1) it has an original maturity of:

(a) at least five years; or

(b) it is subject to five years' notice of repayment;

(2) the claims of the subordinated creditors must rank behind those of all unsubordinated creditors;

(3) the only events of default must be non-payment of any interest or principal under the debt agreement or the winding up of the *firm* and such event of default must not prejudice the subordination in (2);

(4) the remedies available to the subordinated creditor in the event of non-payment or other default in respect of the subordinated loan/debt must be limited to petitioning for the winding up of the *firm* or proving the debt and claiming in the liquidation of the *firm*;

(5) the subordinated loan/debt must not become due and payable before its stated final maturity date except on an event of default complying with (3);

(6) the agreement and the debt are governed by the law of England and Wales, or of Scotland or of Northern Ireland;

(7) to the fullest extent permitted under the rules of the relevant jurisdiction, creditors must waive their right to set off amounts they owe the *firm* against subordinated amounts owed to them by the *firm*;

(8) the terms of the subordinated loan/debt must be set out in a written agreement that contains terms that provide for the conditions set out in this *rule*; and

(9) the loan/debt must be unsecured and fully paid up.

12.3.5 R When calculating its *financial resources*, the *firm* must exclude any amount by which the aggregate amount of its subordinated loans/debts exceeds the amount calculated as follows:

a - b		
where:		
a	=	Items 1 -5 in the table of items which are eligible to contribute to a *firm's financial resources* (see *IPRU(INV)* 12.3.2R)
b	=	Items 1- 5 in the table of items which must be deducted from a *firm's financial resources* (see *IPRU(INV)* 12.3.3R)

12.3.6 G *IPRU(INV)* 12.3.5R can be illustrated as follows:

(1)

Share Capital	£20,000
Reserves	£30,000
Subordinated loans/debts	£10,000
Intangible Assets	£10,000
As subordinated loans/debts (£10,000) are less than the total of share capital + reserves – intangible assets (£40,000) the *firm* need not exclude any of its subordinated loans/debts pursuant to *IPRU(INV)* 12.3.5R. Therefore, total *financial resources* will be £50,000.	

(2)

Share Capital	£20,000
Reserves	£30,000
Subordinated loans/debts	£60,000

Intangible Assets	£10,000
As subordinated loans/debts (£60,000) exceed the total of share capital + reserves – intangible assets (£40,000) by £20,000, the *firm* should exclude £20,000 of its subordinated loans/debts when calculating its *financial resources*. Therefore, total *financial resources* will be £80,000.	

12.4 Notification requirements

12.4.1 G

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
IPRU(INV) 12.2.10R	A change or likely change, in a *firm's financial resources requirement*.	The *financial resources requirement* as recalculated	A greater than 25% increase in the *firm's* total value of the amount of *loaned funds* outstanding compared to the value used in its last *financial resources requirement* calculation	Within 14 *days* of the trigger event

Appendix 1: Glossary of terms for IPRU(INV) 12

If a defined term does not appear in the *IPRU(INV)* glossary below, the definition appearing in the main Handbook Glossary applies.

financial resources	a *firm's* financial resources as calculated in accordance with *IPRU(INV)* 12.3 (Calculation of financial resources).
financial resources requirement	an amount of *financial resources* that a *firm* must hold as set out in *IPRU(INV)* 12.2 (Financial resources requirements).

Annex D

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

2.2.-1 R …

(2) This section applies in relation to other *designated investment business* carried on for a *retail client*:

(a) in relation to a *derivative*, a *warrant*, a *non-readily realisable security*, a *P2P agreement*, or *stock lending activity*, but as regards the matters in *COBS* 2.2.1R(1)(b) only; and

…

…

4.7.5A G …

Warrants and derivatives

4.7.6 R …

…

Non-readily realisable securities

4.7.7 R (1) Unless permitted by *COBS* 4.7.8R, a *firm* must not *communicate* or *approve* a *direct-offer financial promotion* relating to a *non-readily realisable security* to or for *communication* to a *retail client* without the conditions in (2) and (3) being satisfied.

(2) The first condition is that the *retail client* recipient of the *direct-offer financial promotion* is one of the following:

(a) certified as a 'high net worth investor' in accordance with *COBS* 4.7.9R;

(b) certified as a 'sophisticated investor' in accordance with *COBS* 4.7.9R;

(c) self-certified as a 'sophisticated investor' in accordance with *COBS* 4.7.9R;

(d) certified as a 'restricted investor' in accordance with *COBS* 4.7.10R.

(3) The second condition is that *firm* itself or the *person* who will *arrange* or *deal* in relation to the *non-readily realisable security* will comply with the *rules* on appropriateness (see *COBS* 10) or equivalent requirements for any application or order that the *person* is aware, or ought reasonably to be aware, is in response to the *direct offer financial promotion*.

4.7.8 R A *firm* may *communicate* or *approve* a *direct-offer financial promotion* relating to a *non-readily realisable security* to or for *communication* to a *retail client* if:

(1) the *firm* itself will comply with the suitability *rules* (*COBS* 9) in relation to the *investment* promoted; or

(2) the *retail client* has confirmed before the promotion is made that they are a *retail client* of another *firm* that will comply with the suitability *rules* (*COBS* 9) in relation to the *investment* promoted; or

(3) the *retail client* is a *corporate finance contact* or a *venture capital contact*.

4.7.9 R A certified high net worth investor, a certified sophisticated investor or a self-certified sophisticated investor is an individual who has signed, within the period of twelve months ending with the day on which the communication is made, a statement in the terms set out in the applicable rule listed below, substituting "non-readily realisable securities" for "non-mainstream pooled investments":

(1) certified high net worth investor: *COBS* 4.12.6R;

(2) certified sophisticated investor: *COBS* 4.12.7R;

(3) self-certified sophisticated investor: *COBS* 4.12.8R.

4.7.10 R A certified restricted investor is an individual who has signed, within the period of twelve months ending with the day on which the communication is made, a statement in the following terms:

"RESTRICTED INVESTOR STATEMENT I make this statement so that I can receive promotional communications relating to non-readily realisable securities as a restricted investor. I declare that I qualify as a restricted investor because:	
(a)	in the twelve months preceding the date below, I have not invested more than 10% of my net assets in non-readily realisable securities; and
(b)	I undertake that in the twelve months following the date below, I will not invest more than 10% of my net assets in non-readily realisable securities.

Net assets for these purposes do not include:	
(a)	the property which is my primary residence or any money raised through a loan secured on that property;
(b)	any rights of mine under a qualifying contract of insurance; or
(c)	any benefits (in the form of pensions or otherwise) which are payable on the termination of my service or on my death or retirement and to which I am (or my dependants are), or may be entitled.
I accept that the investments to which the promotions will relate may expose me to a significant risk of losing all of the money or other property invested. I am aware that it is open to me to seek advice from an authorised person who specialises in advising on non-readily realisable securities. Signature: Date:”	

…

10.1.2 R This chapter applies to a *firm* which *arranges* or *deals* in relation to a *non-readily realisable security*, *derivative* or *warrant* with or for a *retail client* and the *firm* is aware, or ought reasonably to be aware, that the application or order is in response to a *direct offer financial promotion.*

…

14.3.1 R This section applies to a *firm* in relation to:

(1) *MiFID or equivalent third country business*; and

(2) the following *regulated activities* when carried on for a *retail client*:

(a) making a *personal recommendation* about a *designated investment*; or

(b) *managing investments* that are *designated investments*; or

(c) *arranging*, (*bringing about*) or *executing* a *deal* in a *warrant*, *non-readily realisable security* or *derivative*; or

(d) engaging in *stock lending activity*; or

(e) *operating an electronic system in relation to lending*, but only in relation to facilitating a person becoming a lender under a *P2P agreement*.

…

P2P agreements

14.3.7A G Examples of information a *firm* should provide to explain the specific nature and risks of a *P2P agreement* include:

(1) expected and actual default rates in line with the requirements in *COBS* 4.6 on past and future performance;

(2) a summary of the assumptions used in determining expected future default rates;

(3) a description of how loan risk is assessed, including a description of the criteria that must be met by the borrower before the *firm* considers the borrower eligible for a *P2P agreement*;

(4) where lenders have the choice to invest in specific *P2P agreements*, details of the creditworthiness assessment of the borrower carried out;

(5) whether the *P2P agreement* benefits from any security and if so, what;

(6) a fair description of the likely actual return, taking into account fees, default rates and taxation;

(7) an explanation of how any tax liability for lenders arising from investment in *P2P agreements* would be calculated;

(8) an explanation of the *firm's* procedure for dealing with a loan in late payment or default;

(9) the procedure for a lender to access their money before the term of the *P2P agreement* has expired;

(10) an explanation of what would happen if the *firm* fails, including confirmation that there is no recourse to the Financial Services Compensation Scheme.

…

TP2: Other Transitional Provisions

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provisions: coming into force
2.-2	*COBS*, with the exception of	R	The *rules* listed in column (2) do not apply to an *operator of an electronic*	From 1 April 2014 to 30 September	1 April 2014

	COBS 15		*system in relation to lending* who holds an *interim permission*	2014	
…					
2.-1A	*COBS* 4.7.7R to *COBS* 4.7.10R	R	A *firm* may comply with the *rules* in *COBS* 4.7 as they were in force at 31 March 2014	From 1 April 2014 to 30 September 2014	1 April 2014
…					
2.4-A	*COBS* 10.1.2R	R	A *firm* may comply with the *rules* in *COBS* 10 as they were in force at 31 March 2014	From 1 April 2014 to 30 September 2014	1 April 2014
…					

Annex E

Amendments to the Client Assets sourcebook (CASS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

TP 1 Transitional Provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4)	(5) Transitional provision	(6) Transitional provision: dates in force	(7) Handbook provision: coming into force
-1	*CASS* 1A	R		*CASS* 1A does not apply to an *operator of an electronic system in relation to lending* who holds an *interim permission.*	From 1 April 2014 to 30 September 2014	1 April 2014
…						
11	*CASS* 7 and *CASS* 7A	R		The *rules* listed in column (2) do not apply to an *operator of an electronic system in relation to lending* who holds an *interim permission.*	From 1 April 2014 to 30 September 2014	1 April 2014
12	*CASS* 7 and 7A	R	(1)	The rules in column (2) apply to an *operator of an electronic system in relation to lending* where the *FCA* or *PRA* has granted an application made by the *firm* for *Part 4A permission* and an *interim permission* the *firm* was treated as having has ceased to have effect.	Indefinitely	1 April 2014
			(2)	The rules in column (2) apply in relation to *money* held by the *firm* on the date on which the written notice given by the *FCA* or *PRA* under section 55V(5)		

				of the *Act* takes effect, to the extent that such *money* was received, or is held in the course of or in connection with the *operation of an electronic system in relation to lending* carried on before that date (or business carried on before 1 April 2014 and which would, if conducted on or after 1 April 2014, be *money* which was received, or held in the course of or in connection with the *operation of an electronic system in relation to lending*).		

Annex F

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

16.12.4 R Table of applicable rules containing *data items*, frequency and submission periods

(1)		(2)	(3)	(4)
		Provisions containing:		
RAG number	*Regulated Activities*	applicable *data items*	reporting frequency/ period	due date
...				
RAG 4	• managing investments • establishing, operating or winding up a collective investment scheme • establishing, operating or winding up a stakeholder pension scheme • establishing, operating or winding up a personal pension scheme • managing an *AIF* • managing a *UCITS* • *operating an electronic system in relation to lending* (*FCA-authorised persons* only)	*SUP* 16.12.14R *SUP* 16.12.15R or *SUP* 16.12.15B for *UK designated investment firms*	*SUP* 16.12.14R *SUP* 16.12.16R or *SUP* 16.12.16AR for *UK designated investment firms*	*SUP* 16.12.14R *SUP* 16.12.17R

…				

…

…

In the table in 16.12.15R, between the columns 'IPRU(INV) Chapter 11…' and 'IPRU(INV) Chapter 13', insert the following new column with the following entries in the appropriate places.

16.12.15 R The applicable *data items* referred to in *SUP* 16.12.4R according to type of *firm* are set out in the table below:

…	…	*IPRU(INV)* Chapter 12	…
Annual report and accounts	…	No standard format (Note 13)	…
…			
Balance sheet	…	FSA029	…
Income statement	…	FSA030	…
Capital adequacy	…	FIN069	…
…			
Client money and client assets	…	FSA039	…
…			
Securitisation: trading book	…		
Information on *P2P agreements*	…	FIN070	…

…

In the table in 16.12.16R after 'FIN068' and before Section A RMAR insert the following new rows.

16.12.16 R The applicable reporting frequencies for *data items* referred to in *SUP* 16.12.15R are set out in the table below according to *firm* type. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

FIN069						Quarterly
FIN070						Quarterly

In the table in 16.12.17R after FIN068 and before Section A RMAR insert the following new rows.

16.12.17 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency set out in *SUP* 16.12.16R, unless indicated otherwise.

FIN069				20 *business days*		
FIN070				20 *business days*		

…

16 Annex 24R **Data items for SUP 16.12R**

After FIN068 add the following new data items FIN069 and FIN070, as shown on the following pages. The text is not underlined.

[FCA]

FIN069: Financial resources requirements for operators of an electronic system in relation to lending

Note: this data item must be completed in GBP (£) only

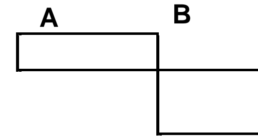
Financial resources

			A	B
1	Qualifying ordinary share capital (excluding preference shares)			
2	Qualifying preference share capital			
3	Eligible LLP member's capital, sole traders capital or partnership capital			
4	Reserves			
5	Share premium account			
6	Interim net profits			
7	Revaluation reserve			
8	Subordinated loans/debt			
9	Less:	Investment in own shares		
10		Investments in subsidiaries		
11		Intangible assets		
12		Interim net losses		
13		Excess LLP member's drawings		
14		Excess subordinated loans/debt		
15	Total deductions			
16	Financial resources			

Annual calculation of financial resources requirement

		A	B	C	D	E
		Total amount of loaned funds	0.2% of first £50m of loaned funds	0.15% of loaned funds between £50m	0.1% of loaned funds between £250m and	0.05% of loaned funds above £500m
17	Total amount of loaned funds					

		and £250m	£500m	



18 Variable financial resources requirement

19 Total financial resources requirement

Financial resources test

20 Surplus/Deficit of financial resources

[FCA] FIN070: Information on Peer-to-Peer agreements

Note: Questions 7A and 12G: Loan terms must be reported in months

		A	B	C	D
		At start of the reporting period	New during the reporting period	Withdrawn during the reporting period	At end of the reporting period
1	Number of investors				
2	Amount invested into loans				

3	Proportion invested into unsecured loans over the reporting period	
4	Average interest rate net of charges and expected defaults over the reporting period	
5	Average expected default rate over the reporting period	
6	Average actual default rate over the reporting period	
7	Average term of new loans over the reporting period	
8	Do you operate a contingency fund?	

If the answer to 8 is "yes" complete the answers to 9 and 10, otherwise go to question 11

9	Total amount held in the contingency fund at the end of the reporting period	
10	Amount held in the contingency fund as a proportion of total loans outstanding at the end of the reporting period	

11 Do you allow investors to choose from different loan categories which have different rates of return and expected default rates?

If the answer to 11 is "no" then do not complete the reminder of the form

If the answer to 11 is "yes" please complete the following information for the loan categories attracting the greatest amount of money, starting with the category raising the greatest amount of investment over the reporting period, up to a maximum of ten.

12 Loan categories

	A	**B**	**C**	**D**	**E**	**F**	**G**
	Total number of investors over the reporting period	Total amount invested over the reporting period	Proportion invested into unsecured loans over the reporting period	Average interest rate net of charges and expected defaults over the reporting period	Average expected default rate over the reporting period	Average actual default rate over the reporting period	Average term over the reporting period
1							
2							
…							
10							

16 Annex 25G Guidance notes for data items in SUP 16 Annex 24R

After the notes for FIN068 add the following new notes. The text is not underlined.

FIN069: Financial resources requirements for operators of an electronic system in relation to lending

Introduction

The purpose is to provide a framework for the collection of information required by the *FCA* as a basis for its supervision function. It also has the purpose to help the *FCA* monitor *firms'* capital adequacy and financial soundness. This data item is intended to reflect the underlying *financial resources requirements* contained in *IPRU(INV)* 12 (as they apply to an *operator of an electronic system in relation to lending*) and facilitates monitoring against the requirements set out there.

Defined Terms

Terms referred to in these notes where defined by the Companies Act 2006, as appropriate, or the provisions of the *firm's* accounting framework (usually UK GAAP or IFRS) bear that meaning for these purposes. Interpretive provisions of the *Handbook* apply to this guidance in the same way as they apply to the *Handbook.* The descriptions indicated in these notes are designed simply to repeat, summarise or amplify the relevant statutory or other definitions and terminology without departing from their full meaning or effect.

- The data item should comply with the principles and requirements of the *firm's* accounting framework, which will generally be UK GAAP (including relevant provisions of the Companies Act 2006 as appropriate) or IFRS.
- The data item should be provided on a solo basis (not on a consolidated basis).
- For a *sole trader*, only the assets and liabilities of the business should be included.
- The data item should be consistent in agreement with the underlying accounting records.
- Accounting policies should be consistent with those adopted in the statutory annual accounts and should be consistently applied.
- Information required should be prepared in accordance with generally accepted accounting standards.
- The data item should not give a misleading impression of the *firm*. A data item is likely to give a misleading impression if a *firm* wrongly omits or includes a material item or presents a material item in the wrong way.
- The requirement that any figures be audited does not apply to small companies exempted from audit under the Companies Act 2006.

Currency
You should report in sterling. Figures should be reported in 000s.

Data Elements
These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

Description	Data Element	Guidance
Financial resources		
	1 to 14	The figures entered in this section should be consistent with those entered in FSA029 submitted for the same reporting period.
Qualifying ordinary *share* capital (excluding preference shares)	1 B	For a definition of this term, see *IPRU(INV)* 12.3.2R – Item 1 (1). This does not include the share premium account (see Data Element 5B).
Qualifying preference *share* capital	2 B	For a definition of this term, see *IPRU(INV)* 12.3.2R – Item 1 (2)
Eligible *limited liability partnership* member's capital, *sole traders* capital or *partnership* capital	3 B	For a definition of this term, see *IPRU(INV)* 12.3.2R – Item 2
Reserves	4 B	For a definition of this term, see *IPRU(INV)* 12.3.2R – Item 3. This figure does not include revaluation reserves (see Data Element 7B) and the share premium account (see Data Element 5B).
Share premium account	5 B	
Interim net profits	6 B	For a definition of this term, see *IPRU(INV)* 12.3.2R – Item 4
Revaluation reserves	7B	
Subordinated loans/debt	8 B	For a definition of this term, see *IPRU(INV)* 12.3.2R – Item 6 and *IPRU(INV)* 12.3.4R. Insert gross figure prior to any excess deductions (see *IPRU(INV)* 12.3.5R). Any subordinated loans/debt excess deduction will be inserted in Data Element 14A.
Less:		
Investments in own *shares*	9A	
Investments in *subsidiaries*	10 A	For a definition of this term, see *IPRU(INV)* 12.3.3R – Note 1
Intangible assets	11 A	For a definition of this term, see *IPRU(INV)* 12.3.3R – Note 2
Interim net losses	12 A	For a definition of this term, see *IPRU(INV)* 12.3.3R – Note 3
Excess *limited liability partnership* member's drawings	13 A	For a definition of this term, see *IPRU(INV)* 12.3.3R – Note 3
Excess subordinated loans/debt	14 A	Insert the figure which is calculated in accordance with *IPRU(INV)* 12.3.5R. For further guidance, please see *IPRU(INV)* 12.3.6G.
Total Deductions	15 B	The sum of cells 9A to 14A
Financial resources	16 B	The sum of cells 1B to 8B minus total deductions (15B).
Annual calculation of financial resources requirement		
Total amount of *loaned funds*	17 A	The *loaned funds* definition is any funds that have been provided to borrowers under a

		P2P agreement through the *operator of an electronic system in relation to lending*. (See *IPRU(INV)* 12.2.5R and *IPRU(INV)* 12.2.8G). Check whether *IPRU(INV)* 12.2.7R or *IPRU(INV)* 12.2.9R should apply when calculating total amount of loaned funds outstanding.
0.2% of first £50m of *loaned funds*	17 B	Insert the figure that equals 0.2% of the volume of *loaned funds* outstanding up to £50m. For further guidance, please see *IPRU(INV)* 12.2.4R and *IPRU(INV)* 12.2.8G.
0.15% of *loaned funds* between £50m and £250m	17 C	Insert the figure that equals 0.15% of the volume of *loaned funds* outstanding above £50m up to £250m. For further guidance, please see *IPRU(INV)* 12.2.4R and *IPRU(INV)* 12.2.8G.
0.1% of *loaned funds* between £250m and £500m	17 D	Insert the figure that equals 0.1% of the volume of *loaned funds* outstanding above £250m up to £500m. For further guidance, please see *IPRU(INV)* 12.2.4R and *IPRU(INV)* 12.2.8G.
0.05% of *loaned funds* above £500m	17 E	Insert the figure that equals 0.05% of the volume of *loaned funds* outstanding above £500m. For further guidance, please see *IPRU(INV)* 12.2.4R and *IPRU(INV)* 12.2.8G.
Variable financial resources requirement	18 A	The sum of cells 17B to 17E.
Total *financial resources requirement*	19 B	The higher of the base requirement *IPRU(INV)* 12.2.4R(1) or the variable financial resources requirement in Data Element 21A.
Financial resources test		
Surplus / deficit of financial resources	20 A	16 B – 19 B

FIN070: Information on P2P agreements

Introduction

The purpose of this data item is to provide a framework for the collection of information required by the *FCA* as a basis for its supervision activities. It will help the *FCA* monitor investor experience and alert us to problems or changes in the risk profile of the market as a whole.

Data Elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

Description	Data Element	Guidance
Total number of investors/ average returns		
Number of investors at the start of the period	1 A	The total number of investors registered with the platform who have funded loans at the start of the reporting period
New investors during the period	1 B	The number of new investors who register

		with the platform and fund loans over the reporting period
Number of investors withdrawing over the period	1 C	The number of investors who cancel their registration during the reporting period
Number of investors at the end of the period	1 D	The total number of investors registered with the platform who have funded loans as at the end of the reporting period
Amount invested at the start of the period	2 A	The total amount loaned as at the start of the reporting period
New money invested during the period	2 B	The amount of new money invested in loans during the reporting period
Money withdrawn during the period	2 C	The amount of money withdrawn from the platform by investors over the reporting period
Amount invested at the end of the period	2 D	The total amount loaned as at the end of the period
Proportion invested into unsecured loans over period	3 A	The proportion (expressed as a percentage to two decimal places) of the amount shown in 2 B accounted for by unsecured loans
Average interest rate net of charges and expected defaults over period	4 A	The average interest rate (to two decimal places) expected by all investors over the reporting period, net of all relevant charges and allowance for expected defaults. Do not make any deductions for tax not paid at source
Average expected default rate over period	5 A	The average expected default rate (to two decimal places) across all loans over the reporting period
Average actual default rate over period	6 A	The average default rate (to two decimal places) across all loans over the reporting period
Average term of new loans over the period	7A	The average term (in months) across all loans over the reporting period
Do you operate a contingency fund?	8A	Answer yes if you operate a contingency fund that aims to cover defaults
Answer the next two questions if you operate a contingency fund that aims to cover defaults		
Total amount held in the contingency fund at the end of the period	9 A	The total amount held in the contingency fund as at the end of the reporting period
Amount held in the contingency fund as a proportion of total loans outstanding at the end of the period	10 A	The amount held in the contingency fund as at the end of the reporting period expressed as a percentage (to two decimal places) of the total amount of outstanding loans
Do you allow investors to choose from different loan categories which have different rates of return and expected default rates?	11A	Answer yes if you allow investors to choose from different loan categories which have different rates of return and expected default rates
If you do not allow investors to choose from different loan categories which have different rates of return and expected default rates, do not provide any further answers **If you do, please complete the following information for the loan categories attracting the greatest amount of money, starting with the category raising the greatest amount of investment over the period, up to a maximum of 10**		
Total number of investors over the period	12A	The number of investors who fund this category of loans over the reporting period
Total amount invested over the period	12B	The amount of money invested in this category of loans during the reporting period

Proportion invested into unsecured loans over period	12C	The proportion (expressed as a percentage to two decimal places) of the amount shown in 12B accounted for by unsecured loans
Average interest rate net of charges and expected defaults over period	12D	The average interest rate (to two decimal places)expected by investors for this category of loans over the reporting period, net of all relevant charges and allowance for expected defaults. Do not make any deductions for tax not paid at source
Average expected default rate over period	12E	The average expected default rate (to two decimal places) for this category of loans over the reporting period
Average actual default rate over period	12F	The average default rate (to two decimal places) for this category of loans over the reporting period
Average term over the period	12G	The average term (in months) for this category of loans over the reporting period

…

TP 1 Transitional Provisions

…

TP 1.2

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
…					
12Y [FCA]	*SUP* 16.12.15R but only in so far as it relates to FIN069 (Capital adequacy), FSA039 (Client money and client assets) and FIN070 (Information on P2P agreements)	R	The *rule* listed in column (2) does not apply to an *operator of an electronic system in relation to lending*.	From 1 April 2014 to 30 September 2014	1 April 2014
12Z [FCA]	*SUP* 16.12.15R but only in so far as it relates to *annual report and accounts*,	R	The *rule* listed in column (2) does not apply to an *operator of an electronic system in relation to lending* who holds an	Indefinitely	1 April 2014

	FSA029 (Balance sheet), FSA030 (Income statement) and FIN069 (Capital adequacy)		*interim permission*.		

Financial Conduct Authority

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