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1 Quality Court  
Chancery Lane  
London  
WC2A 1HR

## New Regulation Bad News for P2P Lenders

Peer-to-Peer (P2P) Lending has smartly stepped into the gap created by the trend of decreasing traditional bank lending to small businesses. The growth of the sector has been remarkable with P2P lending contributing in the region of £1billion to the UK economy in the second quarter of 2018.<sup>1</sup> While P2P Lending has been within the FCA's regulatory perimeter since 1 April 2014,<sup>2</sup> its regulation has to date been distinctly *light touch* in line with the FCA's twin aims of providing adequate investor protection while facilitating (or at least, not preventing) innovation and growth in a new, diverse and growing market that offered alternative sources of finance and investment to businesses and individuals. One particular watershed moment on the P2P Lending journey was the regulatory approval of the Innovative Finance ISA.

In 2016 FCA launched the post implementation review of regulation in the crowdfunding sector (PIR), and in its Consultation Paper (P18/20, July 2018) it highlighted poor business practices and potential for harm that had been identified in the PIR. This, in turn, led to the FCA's consultation on proposed new rules and guidance for P2P Lending.

Following that consultation, the FCA yesterday (4 June 2019) published its new rules for the P2P Lending sector. They come into force on 9 December 2019 by statutory instrument,<sup>3</sup> save that P2P home finance lending becomes subject to MCOB with immediate effect. The whole policy document (including the new rules) is [here](#).

The new regime will cause a headache to P2P lenders. The new rules under COBS 4.7 (1) prohibits communication or approval to a *retail client* of a *direct offer financial promotion* relating to a P2P agreement or a P2P portfolio (this captures web based offerings) unless: the client is a high net worth investor, a sophisticated investor or a restricted investor (in accordance with the existing rules) and rules on *appropriateness* are complied with or the

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<sup>1</sup> Source: Peer2Peer Finance Association (P2PFA), press release 27/9/2018

<sup>2</sup> Article 36 H, Regulated Activities Order (RAO): Operating an electronic system in relation to lending

<sup>3</sup> Operating an Electronic System in Relation to Lending (Peer-to-Peer Lending) Instrument 2019

020 3735 8070

[www.forumchambers.com](http://www.forumchambers.com)

[clerks@forumchambers.com](mailto:clerks@forumchambers.com)

firm itself will comply with the suitability rules (COBS 9 and 9A) or the *retail client* has confirmed that another firm will comply with suitability rules.

This is a heavy blow for the business model of an industry whose typical investor is a *retail client*.<sup>4</sup>

Indeed, in its response to the FCA's consultation the P2PFA had cautioned that the proposed rules on marketing gave rise to significant questions and concerns: the P2P Lending product was largely configured with retail investors in mind, and the proposed retail access restriction would deny access to an investment product that was superior to what was available by way of bank deposit account and with a generally lower risk profile than that inherent in equity investments. The industry body had also expressed its belief that it would be too restrictive to designate P2P Lending within the non-realizable securities regime, and that such designation and regulation would not accurately reflect the nature of the market and would frustrate its development.

The new rules regime requires that (unless the investor is in one of the exempted investor categories (high net worth etc)) a P2P loan can be sold to him only if the P2P lender (or another regulated firm) provides COBS 9 and 9A suitability advice. As a result discretionary P2P Lending appears to have been moved across from non-advised to advised business in relation to non-exempt *retail investors*.

There is, of course, a further exception for *retail investors* that have previously invested, at least twice, in P2P Lending products. The new rule will therefore affect predominantly new business and is likely to slam the brakes on growth in the sector.

The introduction of the *appropriateness* requirement (COBS 10)<sup>5</sup> had been widely expected by P2P lenders, but it had been hoped that the FCA would leave matters there.

The sector will further need to adjust and invest to give effect to new compliance rules and risk management and "wind down" arrangements in SYSC.

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<sup>4</sup> A person who is not a professional investor or an eligible counterparty

<sup>5</sup> COBS 10.2.9G(1) gives guidance on how this requirement may be met by multiple choice questionnaire covering the pertinent matters.

All in all, yesterday was a bad day at the office for P2P Lenders

**Susanne Muth**

Forum Chambers

smuth@forumchambers.com

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