Briefing on the Financial Conduct Authority's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media.

A briefing from the Community Investment Coalition
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The Community Investment Coalition supports increased diversity, choice and innovation in the financial services sector as critical to ensuring access to fair finance. We believe peer-to-peer lenders are an increasingly important player in the market, especially in providing affordable, accessible finance to small businesses. We support regulation as a way of protecting borrowers and lenders. But we believe this needs to be proportionate and should not act as a barrier to new entrants to the market or as an unfair burden on smaller players.

This briefing note provides a quick overview of the FCA's regulatory approach to peer to peer lending.

Background

The Financial Conduct Authority (FCA) published its policy statement regarding its regulatory approach to crowdfunding over the internet and the promotion of non-readily realisable securities by other media.

In October 2013, the FCA published a consultation paper detailing its proposed approach to the regulation of firms operating online crowdfunding platforms or conducting other similar activities. Its policy statement summarises the feedback to the consultation paper, to which there was 98 respondents, and gives the FCA's response to this feedback. The FCA also publishes rules that will come into force on 1 April 2014.

What is crowdfunding?

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.

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.

Summary of feedback and FCA response

Loan-based crowdfunding

The FCA does not consider that it would currently be proportionate to include loan-based crowdfunding platforms within the Financial Services Compensation Scheme (FSCS) remit, although some respondents 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.

As loan-based crowdfunding is not currently within the FSCS remit, the FCA does not expect this to lead to a reduction in new investment. Firms should ensure that investors understand the risks involved. Moreover, other protections that are being introduced – 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

In the consultation paper, the FCA proposed to apply the FCA Principles and core FCA provisions to firms running loan-based crowdfunding platforms. These provisions included conduct of business rules, minimum capital requirements and a requirement for firms to take reasonable steps to ensure existing loans continue to be administered if the firm goes out of business.

Whilst respondents generally agreed with the approach proposed by the FCA, there were concerns relating to capital requirements. Some believed that the proposed requirements were too low. However, at the same time, many respondents who addressed this subject felt that the proposed requirements were too high or suggested an alternative calculation method. The FCA has subsequently decided to take an amended approach that will result in lower capital requirements for some firms in this sector.

Investment based crowdfunding and similar activities

Due to the significant risks investors face when investing in unlisted securities that are hard to value independently or sell on a secondary market, the FCA 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.

The FCA 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.

As a result, the FCA proposes 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.

Moreover, 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. However, the FCA does not think risk warnings on their own provide adequate consumer protection for retail clients who are offered risky and complex nonreadily 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.

For more information

For more information, please contact Jennifer Tankard, Community Development Foundation (CDF) on 020 7812 5430 or jennifer.tankard@cdf.org.uk.

About the Community Investment Coalition

The Community Investment Coalition is a partnership of national organisations including financial providers, charities, trade associations and academic bodies. Our mission is to promote access to affordable finance for families, businesses and communities.

CIC campaigns for:
Increased transparency and public accountability of financial service providers to support consumer choice and allow effective intervention in under-served markets.

Increasing diversity of providers and choice for consumers in the financial services sector, with more providers offering a wider range of fair and affordable products to households, individuals, communities and businesses.

More innovation in the financial services sector so that affordable financial products are delivered accessibly to all communities.

Sustainable local economic growth with a greater share of locally generated income remaining within communities.

Improvements in financial literacy for all sections of the community.

We do this by:

- Collecting and sharing evidence and knowledge through research, conferences and dialogue;
- Campaigning for a regulatory system which helps not hinders community investment;
- Speaking with a unified voice on issues facing the sector; and
- Building the capacity of the Community Investment Sector through infrastructure and collaboration.

Partners include the following organisations:

The Centre for Responsible Credit (CfRC) is a dedicated unit established within the Centre for Economic and Social Inclusion to: monitor the development of credit markets; research models of responsible provision and promote policy responses which protect the long term interests of households.

The New Economics Foundation (nef) is an independent think-and-do tank that inspires and demonstrates real economic well-being. We aim to improve quality of life by promoting innovative solutions that challenge mainstream thinking on economic, environment and social issues. We work in partnership and put people and the planet first.

CCLA manages money for more charities than any other fund manager in the UK and we are owned by our not-for-profit clients. We engage with the banking sector every day on behalf of our charity and local authority clients, who are concerned with issues that may affect shareholder value, but also wish to see account taken of their ethical investment concerns. CCLA is ranked top manager of ethical and responsible investment funds in the UK by assets under management.

Local Trust delivers the Big Local programme with an investment of over £200m from the Big Lottery Fund. Big Local is happening in 150 communities across England over the next 15 years. It provides residents in each community with at least £1m and a range of other support and funding to develop ways of making their areas even better places to live.

CDFA's mission is to support the development of thriving and sustainable community development finance (CDFI) sector that provides finance for disadvantaged and underserved communities and, as a consequence, contribute to the increasing prosperity of these communities.

The Community Development Foundation (CDF) is a social enterprise passionate about helping communities. We have unique expertise in using community development to strengthen local voices, improve people's lives and create better places to live. Our vision is for successful lives in flourishing communities.