

Chapter 18

Specialist Regimes

18.12 Operating an electronic system in relation to lending

Application

- 18.12.1 **R** This section applies to *an operator of an electronic system in relation to lending*, but only in relation to a *person* becoming a lender under a *P2P agreement*.
- 18.12.2 **R** This section does not apply in relation to a current account agreement where:
- (1) there is a possibility that the account holder may be allowed to overdraw on the current account without a pre-arranged overdraft or to exceed a pre-arranged overdraft limit; and
 - (2) if the account holder did so, this would be a *P2P agreement* (overrunning).

Purpose

- 18.12.3 **G** The purpose of this chapter is to ensure that, where applicable, a *firm*:
- prices and values *P2P agreements* fairly and appropriately;
 - will prevent lenders being exposed to risk outside of the parameters advertised at the time of investment;
 - has a reasonable basis to conclude that a *target rate* can be reasonably achieved; and
 - can support the statements made in its disclosures and financial promotions.

Interpretation

- 18.12.4 **R** In the remainder of this section:
- (1) references to a *P2P agreement* include *non-P2P agreements* included in a *P2P portfolio*;
 - (2) unless the context otherwise requires, references to “lender” also include a prospective lender;

- (3) a *firm* is treated as having determined the *price* of a *P2P agreement* in cases other than where the lender and the borrower have entered into a genuine negotiation to determine the *price* of that *P2P agreement*; and
- (4) references to repayment refer to repayment of capital or payment of interest or other charges (excluding any charge for non-compliance with a *P2P agreement*).

Credit risk assessment

18.12.5 **R** Where a *firm* determines the *price* of a *P2P agreement*, it must undertake a reasonable assessment of the credit risk of the borrower before the *P2P agreement* is made.

18.12.6 **R** A *firm* must base its *credit risk assessment* on sufficient information:

- (1) of which it is aware at the time the *credit risk assessment* is carried out;
- (2) obtained, where appropriate, from the borrower, and, where necessary, any other relevant sources of information.

The subject matter of the credit risk assessment

18.12.7 **R** The *firm* must consider the risk that the borrower will not make one or more repayments under the *P2P agreement* by the due date.

Scope, extent and proportionality of the credit risk assessment

18.12.8 **R**

- (1) The extent and scope of the *credit risk assessment*, and the steps that the *firm* must take to satisfy the requirement that the assessment is a reasonable one and based on sufficient information, is dependent upon, and proportionate to, the individual circumstances of each case.
- (2) The *firm* must consider:
 - (a) the types of information to use in the *credit risk assessment*;
 - (b) the content and level of detail of the information to use;
 - (c) whether the information in the *firm's* possession is sufficient;
 - (d) whether and to what extent to obtain additional information from the borrower;
 - (e) whether and to what extent to obtain information from any other sources;
 - (f) whether and to what extent to verify the accuracy of the information that is used; and
 - (g) the degree of evaluation and analysis of the information that is used,
 having regard to the factors listed in (3) where applicable to the agreement.

- (3) The factors to which the *firm* must have regard when complying with (2) and deciding what steps are needed to make the *credit risk assessment* a reasonable one include each of the following where applicable to the agreement:
 - (a) the type of *credit*;
 - (b) the amount of the *credit* or the *credit limit*;
 - (c) the duration (or likely duration) of the *credit*;
 - (d) the frequency of the repayments;
 - (e) the amount of the repayments;
 - (f) the annual percentage rate of charge; and
 - (f) any other costs, including any charge for non-compliance with the agreement, which will or may be payable by or on behalf of the borrower in connection with the agreement.

18.12.9

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The *firm* may have regard, where appropriate, to information obtained:

- (1) in the course of previous dealings with the borrower but should consider whether the passage of time could have affected the validity of the information and whether it is appropriate to update it;
- (2) as part of conducting a *credit-worthiness assessment* in relation to a *P2P agreement* in accordance with ■ CONC 5.5A; or
- (3) as part of assessing affordability in relation to a *P2P agreement* comprising a *home finance transaction*, in accordance with ■ MCOB 11 as modified by ■ MCOB 15.

Policies and procedures for credit risk assessment

18.12.10

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A *firm* must:

- (1) establish, implement and maintain clear and effective policies and procedures:
 - (a) to enable it to carry out *credit risk assessments*; and
 - (b) setting out the principal factors it will take into account in carrying out *credit risk assessments*;
- (2) set out in writing the policies and procedures in (1), and (other than in the case of a *sole trader*) have them approved by its *governing body* or *senior personnel*;
- (3) assess and periodically review:
 - (a) the effectiveness of the policies and procedures in (1); and
 - (b) the *firm's* compliance with those policies and procedures and with its obligations under ■ COBS 18.12.5R to ■ 18.12.8R;
- (4) following the review in (3), take appropriate measures to address any deficiencies in the policies and procedures or in the *firm's* compliance with its obligations;

- (5) maintain a record of each transaction where a *P2P agreement* is entered into sufficient to demonstrate that:
 - (a) a *credit risk assessment* was carried out where required; and
 - (b) the *credit risk assessment* was reasonable and was undertaken in accordance with ■ COBS 18.12.5R to ■ 18.12.8R, and in each case to enable the *FCA* to monitor the *firm's* compliance with its obligations under ■ COBS 18.12.5R to ■ 18.12.8R; and
- (6) (other than in the case of a *sole trader*) establish, implement and maintain robust governance arrangements and internal control mechanisms designed to ensure the *firm's* compliance with (1) to (5).

Pricing, allocation and portfolio composition

- 18.12.11 **R** Where a *firm* determines the *price* of a *P2P agreement* it must ensure that the *price* is fair and appropriate.
- 18.12.12 **R** To determine a fair and appropriate *price* for a *P2P agreement* the *firm* must at least ensure:
- (1) the *price* is reflective of the risk profile of the loan; and
 - (2) the *firm* has taken into account:
 - (a) the time value of money; and
 - (b) the credit spread of the *P2P agreement*.
- 18.12.13 **R** Where a *firm* selects which *P2P agreements* to facilitate for a lender, it must facilitate only those *P2P agreements* which are in line with the disclosures made pursuant to ■ COBS 18.12.27R.
- 18.12.14 **R** Where a *firm* is assembling or managing a *P2P portfolio*, it must ensure that it includes in that *P2P portfolio* only those *P2P agreements* it has determined with reasonable certainty will enable the lender to achieve the *target rate*.
- 18.12.15 **G** To be able to comply with ■ COBS 18.12.14R, a *firm* should use appropriate data and robust modelling. The data may be the *firm's* own or may be sourced from third parties. Modelling could include the *firm's credit risk assessment* of all borrowers under *P2P agreements* included in the *P2P portfolio*, taking into account the expected losses and the variability of losses through the cycle, and the *price* of such agreements as calculated in accordance with ■ COBS 18.12.12R.
- 18.12.16 **R** Where a *firm* determines the *price* of a *P2P agreement* it must review the valuation of each *P2P agreement* in at least the following circumstances:
- (1) when the *P2P agreement* is originated;
 - (2) where the *firm* considers that the borrower is unlikely to pay its obligations under the *P2P agreement* in full, without the *firm*

enforcing any relevant security interest or taking other steps with analogous effect;

(3) following a *default*; and

(4) where the *firm* is facilitating an exit for a lender before the maturity date of the *P2P agreement*.

18.12.17 **R** Where a *firm* that determines the *price* of *P2P agreements* is facilitating an exit for a lender before the maturity date of a *P2P agreement*, the *firm* must ensure that the price offered for exiting the *P2P agreement* is fair and appropriate.

Risk management framework

18.12.18 **R**

(1) Where any of **COBS 18.12.11R** to **18.12.17R** apply, a *firm* must have and use a *risk management framework* that is designed to achieve compliance with those *rules*.

(2) The *firm's risk management framework* must at least:

- (a) be appropriate to the nature, scale and complexity of its business;
- (b) take into account any *credit risk assessment*, *credit-worthiness assessment* or assessment of affordability under *MCOB*;
- (c) categorise *P2P agreements* by their risk, taking into account the probability of default and the loss given default; and
- (d) set out the circumstances in which the *firm* will review the valuation of each *P2P agreement*.

(3) The *firm* must set out in writing the *risk management framework*, and have it approved by its *governing body* or *senior personnel*.

18.12.19 **G** Where **COBS 18.12.11R** to **18.12.17R** do not apply to a *firm*, it would be good practice for the *firm* to consider whether, depending on its business model, it should apply the requirements in **COBS 18.12.18R(1)** to **(3)**.

Monitoring of the risk management framework

18.12.20 **R** A *firm* with a *risk management framework* must:

- (1) assess, monitor and periodically review the adequacy and effectiveness of the *risk management framework*, including by assessing outcomes against expectations;
- (2) pursuant to (1), take appropriate measures to address any deficiencies in the *risk management framework*;
- (3) maintain a record of each transaction where it has used the *risk management framework* to facilitate a *P2P agreement* sufficient to demonstrate that:
 - (a) the *price* of the *P2P agreement* was fair and appropriate in line with the *risk management framework*;

(b) where the *firm* selected which *P2P agreements* to facilitate for a lender, that its selection was in line with the *risk management framework*;

(c) any inclusion in a *P2P portfolio* was in line with the *risk management framework*,

and in each case to enable the *FCA* to monitor the *firm's* compliance with its obligations regarding the *risk management framework*;

(4) establish, implement and maintain robust governance arrangements and internal control mechanisms designed to ensure the *firm's* compliance with (1) to (3); and

(5) allocate to an *approved person* overall responsibility within the *firm* for the establishment and maintenance of an effective *risk management framework* and record that allocation.

Publication of an outcomes statement

18.12.21 **R** Where a *firm* determines the *price* of *P2P agreements* in any financial year of the *firm*, it must publish an *outcomes statement* within four *months* of the end of each financial year.

18.12.22 **R** A *firm* must ensure that each *outcomes statement* remains publicly available for at least 10 years from publication.

Content of an outcomes statement

18.12.23 **R** An *outcomes statement* must include, as applicable, for the financial year of the *firm*:

(1) the expected and actual *default rate* of all *P2P agreements* the *firm* has facilitated by risk category, by reference to the risk categories set out in the *risk management framework*, 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*; and

(3) where the *firm* offered a *target rate*, the actual return achieved.

Information: role of an operator of an electronic system in relation to lending

18.12.24 **R** A *firm* must provide to a lender a description of its role in facilitating *P2P agreements*. That description must include:

(1) the nature and extent of due diligence the *firm* undertakes in respect of borrowers;

(2) 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*;

- (3) whether the *firm* will play a role in determining the *price* of a *P2P agreement* and, if so, what role;
- (4) where lenders do not have the choice to enter into specific *P2P agreements*, what role the *firm* will play in selecting *P2P agreements* for the lender;
- (5) where a *firm* offers a *P2P portfolio* to lenders, what role it will play in assembling or managing that *P2P portfolio*;
- (6) an explanation of the *firm's* procedure for dealing with a loan in late payment or default;
- (7) an explanation of how any tax liability for lenders arising from investment in *P2P agreements* will be calculated;
- (8) whether the *firm* will play a role in facilitating a secondary market in *P2P agreements* and, if so, what role, including:
 - (a) the procedure for a lender to access their money before the term of the *P2P agreement* has expired and the risk to their investment of doing so; and
 - (b) whether the *firm* displays *P2P agreements* that lenders wish to exit and that other lenders may choose to enter into; or
 - (c) whether the *firm* decides if the *P2P agreement* should be transferred to another lender without involving either lender in that decision.

Information: Financial Services Compensation Scheme

- 18.12.25 **R** A *firm* must provide confirmation to a lender that there is no recourse to the Financial Services Compensation Scheme.

Information: P2P agreements where the lender selects the agreements

- 18.12.26 **R** Where a lender has the choice to enter into specific *P2P agreements*, a *firm* must provide the lender with at least the following information about each *P2P agreement*:

- (1) where the *firm* determines the *price* of *P2P agreements*, the *price* of the *P2P agreement*;
- (2) where not provided under (1), the annual percentage rate that will be paid by the borrower in respect of that *P2P agreement*, where applicable to that agreement;
- (3) when the *P2P agreement* is due to mature;
- (4) the frequency of the repayments to be made by the borrower;
- (5) the amounts of the repayments to be made by the borrower;
- (6) the total amount payable by the borrower;

- (7) a fair description of the likely actual return, taking into account fees, *default* rates and taxation;
- (8) where the *firm* determines the *price* of *P2P agreements*, details of the *credit risk assessment*, *credit-worthiness assessment* or assessment of affordability under *MCOB* carried out;
- (9) whether the *P2P agreement* is backed by an asset (for example, secured against property developments) and if so, details of that asset;
- (10) fees to be paid by the borrower or the lender, including any deduction from the interest to be paid by the borrower;
- (11) where the *firm* determines the *price* of *P2P agreements*, the risk categorisation of that *P2P agreement* and an explanation of that risk categorisation, by reference to the risk categories set out in the *risk management framework*; and
- (12) where any of the terms in respect of which information must be provided under sub-paragraphs (1) to (7) is set by auction, a description of the auction process and of how those terms will be determined.

Information: P2P agreements where the firm selects the agreements

18.12.27 **R**

Where a *firm* selects which *P2P agreements* to facilitate for a lender, including where a *firm* offers a *P2P portfolio* to a lender, the *firm* must provide the lender with the following information about the *P2P agreements* it may facilitate for the lender:

- (1) the minimum and maximum interest rate that will be payable under any *P2P agreement* that may be facilitated for the lender;
- (2) the minimum and maximum maturity date of any *P2P agreement* that may be facilitated for the lender;
- (3) a fair description of the likely actual return, taking into account fees, *default* rates and taxation;
- (4) fees to be paid by the borrower or the lender, including any deduction from the interest to be paid by the borrower; and
- (5) the range and distribution of risk categories that the *P2P agreements* may fall into and an explanation of those risk categories by reference to the risk categories set out in the *risk management framework*.

Information concerning platform failure

18.12.28 **R**

- (1) A *firm* must notify each lender of the *firm's* arrangements made under **SYSC 4.1.8AR** to ensure that *P2P agreements* facilitated by it will continue to be managed and administered in accordance with the contract terms between the *firm* and the lender.
- (2) Where a *firm's* arrangements made under **SYSC 4.1.8AR** include particular terms in its contracts with lenders, or include obtaining

particular prior consents from lenders, the *firm* must clearly identify these arrangements and explain how they operate.

(3) Where a *firm's* arrangements made under ■ SYSC 4.1.8AR involve another *person* taking over the management and administration of *P2P agreements* if the *firm* ceases to operate the electronic system in relation to lending, the notification must inform lenders of:

- (a) the identity of the *person* with which the arrangements have been made;
- (b) how that *person* will hold the lenders' money; and
- (c) whether that *person* is authorised by the FCA and, if it is, which relevant *Part 4A permissions* it holds.

(4) A *firm* must also explain to each lender the particular risks to the management and administration of *P2P agreements* in the event of its own *failure*, including:

the possibility that *P2P agreements* may cease to be managed and administered before they mature;

the possibility that any *person* involved in the continued management and administration of *P2P agreements* after the *firm* fails may not be subject to the same regulatory regime and requirements as the *firm*, and the resulting possibility that regulatory protections may be reduced or no longer available; and

the likelihood that the majority of balances due to the lender are those due from borrowers rather than from the *firm* itself, so if the *firm* fails a lender's entitlement to any *client money* held by the *firm* would not include those balances that the *firm* has not yet received from borrowers.

The timing rules

18.12.29 R

- (1) The information to be provided in accordance with ■ COBS 18.12.24R to ■ 18.12.25R and ■ 18.12.27R to ■ 18.12.28R must be provided in good time before a *firm* carries on the relevant business for a lender.
- (2) The information to be provided in accordance with ■ COBS 18.12.26R must be provided each time before a *firm* facilitates a person becoming a lender under a *P2P agreement*, and in good time before doing so.
- (3) Where any of the terms in respect of which information must be provided under ■ COBS 18.12.26R(1) to ■ (7) are set by auction, that information must be provided as soon as reasonably practicable after those terms have been set as a result of the auction.

Keeping the client up to date

18.12.30 R

- (1) A *firm* must notify a lender in good time about any material change to the information provided under the *rules* in ■ COBS 18.12.24R and ■ 18.12.28R.
- (2) The notification in (1) must be given in a *durable medium* if the information to which it relates was given in a *durable medium*.

Ongoing disclosures

18.12.31 **R** A *firm* must ensure that, at any point in time, a lender is able to access details of each *P2P agreement* they have entered into which was facilitated by that *firm*, including:

- (1) the *price* of the *P2P agreement*;
- (2) where not provided under (1), the annual percentage rate that will be paid by the borrower in respect of that *P2P agreement*, where applicable to that agreement;
- (3) the outstanding capital and interest payments in respect of that *P2P agreement*;
- (4) when the *P2P agreement* is due to mature;
- (5) any fees paid in respect of that *P2P agreement* by the lender or the borrower;
- (6) if the *firm* has carried out a valuation of the *P2P agreement*:
 - (a) the most recent valuation;
 - (b) the valuation date; and
 - (c) an explanation of why the *firm* conducted the valuation;
- (7) a fair description of the likely actual return, taking into account fees, *default* rates and taxation;
- (8) where the *firm* determines the price of *P2P agreements*, details of the *credit risk assessment*, *credit-worthiness assessment* or assessment of affordability carried out under *MCOB*;
- (9) whether the *P2P agreement* is backed by an asset (for example, secured against property developments) and if so, details of that asset;
- (10) where the *firm*:
 - (a) determines the *price* of *P2P agreements*;
 - (b) selects which *P2P agreements* to facilitate for a lender; or
 - (b) offers a *target rate*,

the risk categorisation of that *P2P agreement* and an explanation of that risk categorisation, by reference to the risk categories set out in the *risk management framework*;
- (11) whether the *firm* considers that the borrower is unlikely to pay its obligations under the *P2P agreement* in full without the *firm* enforcing any relevant security interest or taking other steps with analogous effect and, if so, information to that effect; and
- (12) whether a *default* by the borrower under a *P2P agreement* has occurred and, if so, information to that effect.

Information: form

- 18.12.32 **R** The *documents* and information provided in accordance with ■ COBS 18.12.24R to ■ 18.12.28R and ■ COBS 18.12.31R must be in a *durable medium* or available on a website (where that does not constitute a *durable medium*) that meets the *website conditions*.

Contingency funds: standardised risk warning

- 18.12.33 **R**
- (1) In addition to any other risk warnings that must be given by a *firm*, a *firm* must provide the following risk warning to a lender when it offers a *contingency fund*, modified as necessary to reflect the terminology used by the *firm* to refer to a *contingency fund*:

“The contingency fund we offer does not give you a right to a payment so you may not receive a pay-out even if you suffer loss. The fund has absolute discretion as to the amount that may be paid, including making no payment at all. Therefore, investors should not rely on possible pay-outs from the contingency fund when considering whether or how much to invest.”
 - (2) The *firm* must provide the risk warning in a prominent place on every page of each website and mobile application of the *firm* available to lenders containing any reference to a *contingency fund*.
 - (3) Where the lender has not approached the *firm* through a website or mobile application, the risk warning must be provided in a *durable medium* in good time before the *firm* carries on any business for that lender.

- 18.12.34 **R** The standardised risk warning must be:

- (1) prominent; and
- (2) contained within its own border and with bold text as indicated.

Contingency funds: published policy

- 18.12.35 **R**
- (1) A *firm* which offers a *contingency fund* to lenders must have a *contingency fund policy*.
 - (2) The *contingency fund policy* must contain the following information:
 - (a) an explanation of the source of the money paid into the fund;
 - (b) an explanation of how the fund is governed;
 - (c) an explanation of who the money belongs to;
 - (d) the considerations the fund operator takes into account when deciding whether or how to exercise its discretion to pay out from the fund, including examples. This should include:
 - (i) whether or not the fund has sufficient money to pay; and
 - (ii) that the fund operator has absolute discretion in any event not to pay or to decide the amount of the payment;

- (e) an explanation of the process for considering whether to make a discretionary payment from the fund; and a description of how that money will be treated in the event of the *firm's* insolvency.
- (f) The *contingency fund policy* must be provided on every page of each website and mobile application of the *firm* available to lenders and must be:
 - (3) The *contingency fund policy* must be provided on each website and mobile application of the *firm* available to lenders and must be:
 - (a) prominent;
 - (b) in an unrestricted part of the website or mobile application; and
 - (c) accessible via a link contained in the standardised risk warning in ■ COBS 18.12.33R.
 - (4) Where the lender has not approached the *firm* through a website or mobile application this information must be provided in a *durable medium* in good time before the *firm* carries on any business for that lender.

18.12.36 **G** When deciding whether to pay out from the *contingency fund*, a *firm* should take into account fairness to lenders and whether the lender made an active choice about whether or not to participate in the *contingency fund*.

Contingency funds: information when the fund is used

- 18.12.37 **R**
- (1) A *firm* must notify a lender if they receive payment from a *contingency fund*.
 - (2) This notification must state the amount paid to the lender from the *contingency fund*.
 - (3) This notification must be provided either:
 - (a) at the time the payment is made; or
 - (b) on an aggregated basis at least once every three *months*.

Contingency funds: information about how the fund is performing

18.12.38 **R** A *firm* which offers a *contingency fund* must make public on a quarterly basis the following facts about how the fund is performing:

the size of the fund compared to total amounts outstanding on *P2P agreements* relevant to the *contingency fund*;

what proportion of outstanding borrowing under *P2P agreements* has been paid using the *contingency fund*; and

a *firm* must:

- (a) only include the actual amount of money held in the *contingency fund* at the relevant time, net of any liabilities or pay outs agreed but not yet paid; and

(b) not include any amounts due to be paid into the *contingency fund* that have not yet been paid into it.

Past performance

18.12.39 **R** A *firm* must ensure that information that contains an indication of past performance only contains information that is reflective of the actual payments received by lenders from borrowers under *P2P agreements*.

18.12.40 **G** One of the consequences of **■ COBS 18.12.39R** is that payments made to lenders from a *contingency fund* should not be reflected in any information that contains an indication of past performance. Firms should also take into account the effect of commissions, fees and other charges.