BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

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Dear Andrew

Thank you for your letter of 1 June regarding crowdfunding.

The PRA is not the prudential regulator for crowdfunding platforms, and as such does not routinely assess risks to the crowdfunding sector or its resilience to shocks. As the prudential regulator for banks, however, the PRA does monitor any rapid growth of exposures by banks to new asset classes. In addition, the FPC seeks to identify and monitor systemic risks beyond the banking sector as part of its statutory objective to protect and enhance the stability of the financial system. The Bank may examine crowdfunding and related sectors in these respects.

Peer-to-peer lending (or debt-based crowdfunding) platforms provide an alternative source of generally unsecured credit for consumers and small businesses. Survey evidence suggests that P2P consumer platforms originate loans to similar customers to banks, while P2P business platforms often lend to firms unable to access bank credit.[1] The key difference between bank and P2P lending is that a bank intermediates between the depositor and borrower by acting as principal, while a P2P firm acts as agent and does not take principal risk. This changes the nature of the risk and the "promise" to funding parties made by P2P firms relative to that of a deposit contract with a bank. It is particularly important that the "promise" made by P2P firms in their marketing is unambiguous and clear since there is no protection to those providing funds in the event that the underlying investment fails. Likewise, it is very important that those providing funds understand the terms of their investment and particularly whether or not it is a Collective Investment Scheme.

Currently, lending activity through peer-to-peer platforms is small compared to other channels: peer-to-peer consumer loans were around 1-2% of both stocks and gross flows of total non-card consumer credit over 2015; and peer-to-peer business loans were around 1% of outstanding stocks and 2% of gross flows of bank loans to SMEs (businesses with an annual turnover of less than £25 million) over the same period.[2] By some estimates, peer-to-peer business lending is more significant when compared to bank lending to small businesses (broadly defined as those with an annual turnover of less than £1-2 million), amounting to almost 14% of equivalent gross bank lending flows in 2015.[3] Though currently small, the peer-to-peer sector is growing rapidly: gross flows of new peer-to-peer business and consumer lending grew by 99% and 66% respectively in 2015.

[1] The 2014 UK Alternative Finance Industry Report.
[2] Comparing peer-to-peer lending figures published by the P2P Finance Association to published aggregates for MFI loans to small and medium-sized enterprises and consumer credit lending excluding credit cards and the Student Loans Company.
[3] The 2015 UK Alternative Finance Industry Report, Nesta and Judge Business School, University of Cambridge, page 14

Equity crowdfunding platforms facilitate equity investments in small, generally early-stage businesses. Equity crowdfunding flows are smaller than those for peer-to-peer loans, amounting to £332 million in 2015 compared to over £2 billion for peer-to-peer loans. Institutional investments accounted for less than 10% of equity crowdfunding flows in 2015.

As regards the financial system's exposure to peer-to-peer loans, the proportion of loans funded by institutional investors was less than a third in 2015.[4] The first securitisation of peer-to-peer loans in the UK happened in April this year, and further securitisations could increase the prevalence of institutional funding in the future. Institutional investors may be banks or other types of financial firm, such as hedge funds or asset managers. From a supervisory perspective, we understand there is currently very limited direct bank investment in peer-to-peer loans.

Risks arising from peer-to-peer loans will depend in part on the underwriting standards of peer-to-peer platforms. Since the sector is still relatively young, there is as yet limited evidence on how the quality of peer-to-peer loans behaves over a credit cycle. There is also limited evidence on how the sector will respond to a higher interest rate environment, on how pro-cyclical is the sector's funding and its loan origination activity—that is, whether platforms struggle to attract new investment and write new loans during a downturn—and how sensitive are investor flows to news about the industry. In addition, a significant increase in activity in the peer-to-peer sector could potentially amplify risks in specific sectors such as real estate and property development, since a sizeable portion of peer-to-peer business lending is concentrated there.[5]

In the Bank's judgement, the crowdfunding sector is currently too small to be systemically important to the UK financial system, though this judgement may change if the sector continues its recent high rates of growth. The Bank will continue to monitor growth in the sector and any prudential risk it may pose to the firms it supervises and to the financial system more broadly.

I hope these answers help.

Yours Sincerely

Andrew

Andrew Bailey

[4] The 2015 UK Alternative Finance Industry Report, Nesta and Judge Business School, University of Cambridge.
[5] The 2015 UK Alternative Finance Industry Report, Nesta and Judge Business School, University of Cambridge.