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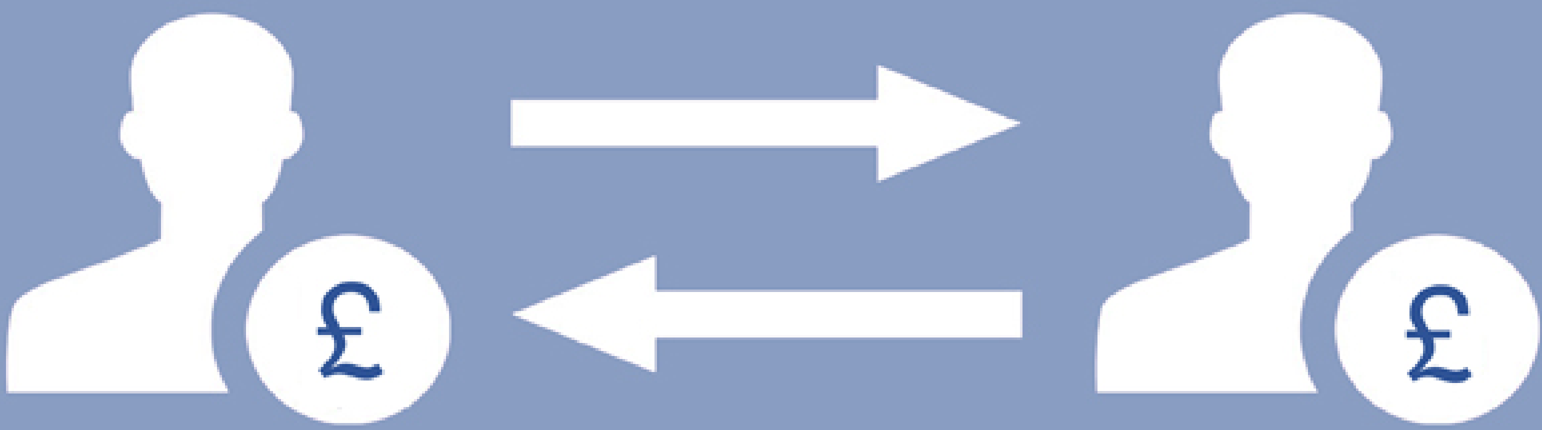
Premierline BUSINESS INSURANCE from Allianz

Peer to Peer Lending Guide



Bovill MoneyComms peer2peer FINANCE ASSOCIATION p2pmoney

Contents

What is peer to peer lending?

Peer to peer lending is a form of debt crowdfunding that involves many individuals lending money to an individual or an existing business via an online P2P lending platform.

It is a form of alternative finance that more and more small businesses are using as a business finance solution to raise money for expansion and to fund projects. In fact, according to Nesta, the average growth of the P2P business lending market was 250% between 2012 and 2014[1].

The UK is one of the global leaders in peer to peer lending alongside the USA and China. P2P lending platforms are the largest forms of modern finance in the UK[2], with lenders anticipated to have lent £1bn in 2014 [3].

Although it is growing, P2P lending is still quite a niche area, as Andrew Hagger, personal finance commentator at MoneyComms, explains. "The IT and technology sectors are more aware of P2P lending than others. But as more businesses are pointed to it through banks such as RBS (who now refers customers to Funding Circle and Assetz Capital), that awareness is only going to go up."

Why P2P business lending is growing so quickly?

- These days people are used to doing everything online, like reading maps, shopping and telephony, so why not business borrowing too?
- Following the FCA's decision to regulate the P2P lending market in April 2014, it is now considered a viable alternative to other types of loan.
- In late 2014, the Chancellor talked about potentially setting up a new type of ISA specifically for P2P loans, allaying many investors' fears about the risks and so making it a more popular investment option for lenders.
- P2P business lending is relatively fast and easy compared to other types of borrowing.
- Interest rates are often lower than are available through other types of finance.
- Fees and other costs can be the lowest on the market.
- Often (but not always) there are no early repayment charges.

Why choose peer to peer business lending?

Over recent years Britain's banks have earned themselves an unwelcome reputation for declining too many loan applications from small businesses and charging high interest rates to those who do borrow from them. As a result, more small businesses are raising funds through alternative finance, a market that, as a whole, is predicted to reach £4.4bn this year[4].

Not only are small businesses using P2P borrowing more often, but they're getting positive results as well. For example, turnover grows in 70% of SME business borrowers who raise money through P2P business borrowing. 63% of them see a growth in profit[1]. That's a powerful link and a good reason to consider choosing it next time you need funds.

[1]http://www.nesta.org.uk/sites/default/files/understanding-alternative-finance-2014.pdf
[2]http://www.grant-thornton.co.uk/Documents/financial-services/Alternative-Lending-regulatory-approach-to-Peer-to-Peer-lending.pdf
[3]http://p2pfa.info/wp-content/uploads/2014/10/Peer-to-Peer-Lending-DataSheet-Q3-v3.pdf
[4]http://www.nesta.org.uk/news/alternative-finance-market-set-double-2015

What is peer to peer lending?

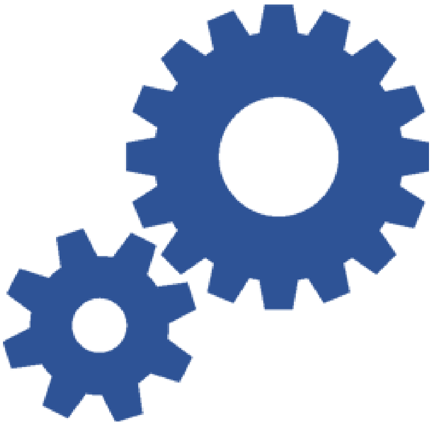
Nesta asked P2P businesses borrowers what they were seeking a loan for: the biggest proportion, 41%, wanted it for expansion and/or growth capital. This lean towards using P2P business loans for growth as opposed to working capital (which is why 85% of business use invoice finance to raise money) might help raise the proportion of high-growth companies in the UK, which has been dwindling in recent years[5]. Along with the chance of more profitable growth too, the whole economy is set to benefit.

Why small businesses are choosing P2P business lending over bank borrowing?

- Small businesses are disgruntled with the banks, who are often unable to lend to some small business because they fail stringent lending criteria.
- Lower interest rates are available partly because P2P business lending platforms don't have high street branches to run.
- It's faster –the speed of access to funding and the ease of platform use are valued highly by P2P business borrowers[1].
- It's easier – 91% of P2P business borrowers think it's an easier way to get funded than traditional channels[1].
- There's no middleman – the individual lenders put money directly into the business using the P2P platform as a tool to do so.
- It's up to the public if a business receives the loan, rather than a banking institution.

[5]http://www.cebr.com/reports/growing-pains-for-uk-smes/

How does P2P business lending work?



P2P business lending is all about matching businesses that want to borrow money with individual lenders online via a P2P lending platform. Although the exact process varies between platforms, the usual order of events is for a business to apply to join their chosen platform online by filling in a form. Their paper work is then scrutinised by the platform. If their loan request is successful, it gets listed on that platform's 'marketplace'. Investors, who will have been through their own registration and verification process with that platform, will then offer money to fund the loans that they think will give them the best returns. The amount they offer varies, as does the number of investors that offer – it can be in the thousands.

On most platforms the investors choose what interest rate they would be happy to lend at. These are called auction P2P lending platforms and include Funding Circle and Thin Cats. A market platform is where the platform itself lends the money, and then resells segments of that loan to their investors. Wellesley & Co. is one such platform.

Once the loan target has been met the borrower can accept the loan and the funds are released (so long as all the paperwork is in place). Loans, along with any interest payments and fees owed to the platform, are usually paid back in equal monthly instalments.

How to choose which platform to use

So, you've researched all your options for raising finance, both via the banks and using alternative finance (try the CBI's FindmyFinance tool to see which types could work for you), and you've decided that P2P lending is the most cost effective and appropriate route for your business.

Before you go any further, you need to decide what type of loan you're after. Will it be secured or unsecured? Or are you looking for asset or property finance? Are you prepared to offer a personal guarantee? Knowing this up front will determine which P2P lending platforms are going to be appropriate for you.

Factors to consider when choosing a platform

- How easy is the platform to use, for you and for the investors you're hoping to attract?
- What fees are payable, are they fixed or variable depending on the size and term of your loan, are they reimbursable?
- Is there a minimum interest rate and if it changes as investors bid their money, how does it change?
- There are two types of lending model used by P2P lending platforms:
    - Auction sites are where lenders bid on loans with the lowest rates winning.
    - Market sites are where lenders offer funds at defined interest rates.
- Lending periods vary from one month to five years and more.
- Different platforms attract different types of investor and some allow you to sort by investor experience so you can match them to your business and needs.
- What types of repayment schedule are available, are they flexible and how are they administered?
- Many platforms do not charge an early repayment fee on loans, but not all.

The fees charged by P2P lending platforms are a bit of a minefield, and in the past businesses have been stung by high and unexpected costs. But as the industry has matured the costs of borrowing and the chance of there being hidden fees have reduced.

"It has taken a long time for a lot of the P2P platforms to become profitable," says Ian Gurney from P2Pmoney.co.uk, "so it is only now that their fees are starting to come down."

Websites like Ian Gurney's, try to monitor all the platforms' fees to give potential borrowers a way of comparing prices. But with so many different fee structures it can be hard to work out which is the cheapest overall.

How to choose which platform to use

Which peer to peer lending UK platforms are for business borrowers?

The list of platforms offering loans to small businesses today is likely to be different to the list in a year's time because P2P platforms are appearing and disappearing all the time. The reasons for this are many and varied, but suffice it to say that in general the longer the platform has been established, the more evidence you have for its longevity into the future.

"The most successful platforms are those that manage to grow their numbers of lenders at the same rate as their number of borrowers," says Ian Gurney. "Funding Circle has done a great job of managing the supply and demand on their platform – something that is particularly hard to do and has caused the demise of platforms in the past."

For now, listed below are the P2P lending platforms that offer loans to limited companies using the auction model.

Platform	Loan amounts available	Loan terms available	Amount lent
Funding Circle	£5,000 to £1 million	6 months to 5 years	More than £600 million
ThinCats.com	£50,000 to £3 million	6 months to 5 years or more	More than £110 million
assetz CAPITAL	None published	3 months to 5 years	More than £70 million
fundingknight	£25,000 to £500,000	6 months to 5 years	More than £15 million
rebuildingsociety.com	£25,000 to £2 million	6 months to 5 years	More than £6 million
funding tree Crowdfunding - The Smarter Way	£10,000 to £1 million	1 month to 5 years	More than £650,000
Funding Empire™	£5,000 to £100,000	6 months to 5 years	More than £100,000

Data correct as of May 2015

Wellesley & Co (wellesley.co.uk) is a market platform that has lent more than £150 million in secured loans. If you're a sole trader, you can also raise funds for your business through RateSetter and Zopa.

What are the risks?

Since peer to peer lending became regulated by the FCA in April 2014, the risks involved have come down. However, each platform has its own leadership team, terms and conditions, investor and borrower vetting processes, lending criteria and much more. So research is vital if you want to minimise your exposure to the risks.

The biggest risk perceived by P2P lenders is that the platform goes bust. FCA regulation means that if a site closes, repayments from business borrowers on existing loans will continue. This is because P2P sites have to have insurance to pay for a third party collection agency.

For P2P borrowers, it's important to carefully work out what fees are applicable to the loan you're applying for. Transparency of the costs associated with raising money through a P2P platform is getting better, but that doesn't mean that you're guaranteed to avoid any nasty surprises. So do the maths once, twice and three times, then check it thrice too, before committing.

The very fact that P2P lending takes place online can potentially blur the lines when it comes to legal jurisdiction. If people from lots of different countries lend you money through your chosen P2P platform, they may have different laws for collecting their debts. The European Commission is still finding its way on this topic.

Finally, as with any borrowing, if security is taken (usually in the form of property, debentures or personal guarantees), these may be at risk if you don't keep up your repayments.

How is P2P lending regulated and monitored?

Since 1 April 2014 the Financial Conduct Authority (FCA) has regulated the P2P lending market. The FCA has set out a series of standards to which all P2P platforms should now comply, however most are aimed at protecting investors, not borrowers. "The regulation isn't particularly onerous either," says Ian Gurney from P2Pmoney.co.uk. To read an unofficial outline of the FCA's regulatory requirements of the industry, click here.

Unusually, however, regulation has been welcomed by the P2P sector as a whole. "Most industries shy away from regulation," says Ian Gurney, "but the established platforms understood that regulation would make P2P lending more popular because the public would see it as a more mature alternative to bank finance."

With just a year of regulation under its belt, there's still a long way to go before it is water tight, as Gillian Roche-Saunders from Bovill Financial Services Regulatory Consultants explains: "Since the FCA took over regulation of the industry only 12 months ago, the regulator and the existing P2P lending platforms are still finding their feet as to how the Consumer Credit rules apply." The authorisation process is a long and complicated one, so the FCA has given each platform a date between about June and October 2015 to complete the process. "The Consumer Credit Register authorisation process is the FCA's way of filtering out those platforms that should not have a place in the market," continues Gillian. "The process of giving them full authorisation could take six months and there's likely to be little information available from the FCA during that process."

For now, small business borrowers shouldn't necessarily be concerned about a platform that isn't fully authorised. They can take comfort from the fact that there haven't been any high profile problems in P2P business lending in general so far. "While the market is still young, each platform is working very hard to get the right loans for the right businesses," explains Gillian Roche-Saunders, "because the platform's reputation is at stake. They are being careful to offer the right agreements to protect their investors as much as themselves."

What are the risks?

"The authorisation process through which these platforms have to go to become authorised is rigorous," says Gillian Roche-Saunders. "The platform needs to make a large and experienced team available, who themselves are scrutinised during the process. So looking at the background of the teams operating the platform will give you a good idea of the quality of that platform overall, and its likelihood of being given full permissions at some point this year."

However, as competition increases, and there are more entrants into the market, the standards could start to drop. So it's always worth keeping an eye on the media and finding out about platforms mysteriously disappearing or researching whether P2P lenders or borrowers are dissatisfied with a platform.

So far there haven't been any public announcements of FCA enforcement action against P2P platforms, but they did recently publish a review of crowdfunding[7] where failings such as deleting negative comments on pitch forums and making the risks of borrowing insufficiently clear were identified.

In addition to regulation from the FCA, the Peer 2 Peer Finance Association (P2PFA) is a trade body originally set up by Zopa, RateSetter and FundingCircle to promote high standards of conduct and consumer protection in the sector. It now has nine members and Christine Farnish CBE is its independent chair. "P2PFA members adhere to a code of conduct which encourages best practice for consumers," says Christine. "This means investors have more confidence to use P2PFA member platforms to fund loans. The credit checks run by the member platforms on business borrowers are thorough and the pricing of the loan will be more accurate to the risk level it represents."

[7]http://fca.org.uk/your-fca/documents/crowdfunding-review

What is British Business Bank backing?

The British Business Bank Investment Programme was launched in 2013 to try to help give small businesses better access to finance. So far it has pumped £400 million of state funding into lenders to small businesses, including £40 million to Funding Circle and £10 million to each of Zopa and RateSetter. The aim is to make it easier for these platforms to lend money because it improves their liquidity. However, just because a platform hasn't had British Business Bank funding, it doesn't necessarily mean that it's not a reputable website to use for your loan.

Some commentators are concerned about the involvement of the British Business Bank in only a select few platforms. They see the potential for those with their backing to be able to offer more competitive rates as those without it. "Even though the credit scoring has to remain as robust," says Andrew Hagger from MoneyComms, "these platforms could pass savings onto their customers by offering better rates of borrowing. As a result, we could potentially end up with a monopoly of P2P lending providers, which wouldn't be good for the industry."

How to improve your chances of attracting lenders at a favourable rate

As with any form of crowdfunding, whether and how successful your fundraising is depends to a great extent on how well you attract the crowd to your project.

The first thing to know about your audience is that they're most likely to be over 55 years of age and their primary motivation for investing is to get a financial return. They're not as interested in backing local business or supporting social causes in the same way that reward or donation crowdfunding investors are[1].

Why people are investing more in P2P lending:

- Better rates of return are available when compared other forms of investment
- Investors are disgruntled with the banks and nervous about investing in major financial markets
- In the 2014 Autumn Statement the Chancellor suggested that individuals will be able to offset losses from bad loans against other P2P gains.
- There is currently a consultation going on as to whether to extend ISA eligibility to lenders using crowdfunded debt-based securities but the timescales are unclear.

As well as the factors we listed in our crowdfunding guide, remember that the following are also very relevant to potential lenders when raising funds through P2P lending:

- Your credit history, both your own and your business's
- Your company financials, including its profitability and the strength of its cash flow
- How you come across personally in your pitch – the more professional, knowledgeable and trustworthy you sound, the more attractive your project will be
- Be clear about what difference the loan will make, not only to your business but also to your customers and society in general
- The strength and involvement of your existing network
- The quality and effectiveness of your social media activity

How to improve your chances of attracting lenders at a favourable rate

One of the most important areas for you as a P2P business borrower to focus on is answering questions posed by potential lenders about your project. Responding quickly, accurately and in as much detail as possible will significantly improve your chances of converting those potential lenders into actual investors.

“Investors’ questions and your answers are available for anyone registered to that particular P2P lending platform to see,” warns Ian Gurney, “so while you must be full and honest in your responses, be careful what you say and don’t give away any confidential information. Forums like P2Pindependentforum.com are a great place for potential investors to share information, and while they shouldn’t attribute information to particular borrowers, there is still a chance your business could be associated with some comments. So be careful.”

Some small businesses list several loans on different platforms at the same time, and then only choose to accept one of them when the auctions finish. This can be a good way of getting the best rate on the market, but be mindful of having to pay listing fees for the pleasure. Others choose to take more smaller loans from multiple platforms rather than a bigger loan from one.

“The key to making both these approaches work is being open and honest with your investors,” says Ian Gurney. “Often investors themselves lend money on multiple platforms to spread their own risk. So if, during an auction, they find out they’re actually investing in the same business just through a different platform, they may not like it and so not fund your loan.”