DRN-3043060

The complaint

Mr S complains that Crowdcube Capital Limited gave him misleading information about a company ("A") he invested in through its platform. He wants Crowdcube to reimburse him for his losses.

What happened

Crowdcube operates an equity crowdfunding platform. Investors like Mr S can invest in shares of what are generally small or start-up companies, with Crowdcube arranging their investment.

Mr S invested in company A through Crowdcube's platform. As well as the funds it was raising through Crowdcube, A had a loan facility with a bank, B. The second tranche of this loan was due to be released a few months after the crowdfunding round. When the time came, B didn't release the additional funds because A hadn't met certain revenue targets built into the terms of the loan. Shortly afterwards, A was sold, resulting in Mr S making a substantial loss on his investment.

Mr S then discovered that, before the round of crowdfunding, A had breached another of the covenants of the loan. He complained to Crowdcube, saying it should have disclosed this breach in the pitch on its website, or the accompanying documents it sent him about A. He said it should refund his losses.

One of our investigators looked into things, and didn't think Crowdcube had done anything wrong. He said Crowdcube had warned Mr S the investment in A was high risk and that the company could fail. On its website it also said investors should take care to carry out their own due diligence on prospective investments. He thought Crowdcube's communications about the investment in A had been clear that the company had existing bank borrowing, with covenants attached. Overall he thought it had done enough to explain the risks of the investment and had presented information about A in a clear way.

Mr S didn't agree and asked for an ombudsman to decide the matter. I then wrote to Crowdcube to say I didn't agree with our investigator, and thought the loan covenant breach was something it ought to have disclosed to investors like Mr S.

Crowdcube responded to say it thought it had fulfilled its obligations to Mr S. In summary it said:

- A didn't breach any covenants of the loan with B after the crowdfunding round was completed. The withholding of the second tranche of the loan was due to A's failure to meet different conditions of the agreement, and was unrelated to the previous breach.
- Crowdcube provided appropriate and proportionate information about A and its financial standing, in line with the regulator's guidance.
- It wouldn't be reasonable to expect the information it provided to cater for Mr S's particular view of what risks the investment posed.

- There aren't any rules about the level of due diligence Crowdcube needed to carry out. It did however explain to Mr S what analysis it had carried out so he could decide how much if any additional information he might want or need. This reflected the FCA's view on what they'd expect from crowdfunding platforms.
- Mr S had never shown any interest or concern in companies' loan facilities when making previous investments. So Crowdcube didn't think Mr S would have invested differently, even if he'd known about the covenant breach.

I issued a provisional decision about the matter, in which I said:

What were Crowdcube's obligations?

It isn't in dispute that Crowdcube promoted the investment in A to Mr S, and that it arranged it for him. Neither party contends that Crowdcube shouldn't have promoted the investment to Mr S, or that this wasn't an appropriate investment for him. For completeness I'm also satisfied that the relevant rules on restricted promotion and appropriateness were followed.

This complaint is, at its heart, about the information Crowdcube supplied to Mr S about A.

I've considered Crowdcube's obligations under the FCA's rules. Particularly that it needed to have regard for Mr S's interests and treat him fairly (Principle 6); and ensure its communications or promotions were fair, clear and not misleading (COBS 4.2.1R).

I've also thought carefully about what Crowdcube's said about the due diligence the regulator expects it to carry out. I acknowledge that the rules and guidance in this area aren't prescriptive. But I don't think the level of due diligence Crowdcube carried out here is the central issue. It's not in dispute that Crowdcube knew about the covenant breach, so this complaint centres on the question of whether it ought to have included that information in what it told Mr S about the investment in A.

I note that in its policy statement PS14/4 the FCA said of the due diligence expected of crowdfunding firms (my emphasis):

"we expect sufficient detail to be provided to give a balanced indication of the benefits and the risk involved, including whether or not any due diligence has been carried out on an investee company, the extent of the due diligence and ***the outcome of any analysis****."*

In 2015 the FCA issued a review of the regulatory regime for crowdfunding where it said:

"Firms need to provide investors with appropriate information, in a comprehensive form, so that they are reasonably able to understand the nature and risks of the investment, and, consequently, to make investment decisions on an informed basis".

One of the areas of concern the FCA identified was a situation where a platform provided:

"Insufficient, omitted or the cherry-picking of information, leading to a potentially misleading or unrealistically optimistic impression of the investment."

So Crowdcube needed to ensure any information it gave Mr S about A was fair, clear, and not misleading, and enabled him to make an informed decision whether to invest, armed with knowledge of the nature and risks of an investment into the company.

Should Crowdcube have mentioned A's covenant breach in its communications with Mr S?

Crowdcube provided Mr S with a 'financial snapshot' document about A as well as an explanatory note with more information about the company.

The explanatory note says A has an agreement to borrow a total of £3.5million from B. At the time of the crowdfunding raise, it had drawn down £2million of the facility, with the rest available to be drawn down some months later. The note goes on to say this second tranche is dependent on A meeting revenue targets. It also says there are financial covenants in the loan agreement relating to A's cash and revenue, and that these covenants are in the process of being amended. Similarly, the financial snapshot mentions the covenants and says A needs to hold particular levels of cash.

In my view, going into detail about the covenants in place, and the fact they were being renegotiated – but failing to say why, or that they'd previously been breached – failed to give a full and clear picture of the loan arrangement. I don't think omitting mention of the prior breach gave Mr S appropriate information to allow him to understand the risks of the investment.

The documents give no indication that A was concerned about its ability to meet the loan covenants, and says it thinks the crowdfunding raise should give them enough cash to meet their debt covenants for some time.

I think this was misleading. I'm satisfied the notes let investors know of the loan arrangements with B and that they were subject to covenants on A. I think investors like Mr S would therefore have understood A's ability to meet those covenants was a particular risk of investing in this company. And I think knowledge of how A had performed against those covenants in the past would be a material and important fact allowing investors to make an informed judgement about the risk, and whether it was one they were willing to accept.

Crowdcube has argued that the first breach related to cash consumption, but the later breach - which resulted in the second tranche of borrowing being withheld - related to revenue. I don't think that matters. Whether or not the same covenant was breached, the way A had managed its borrowing in the past would help inform investors about how well it was likely to do so in future. I don't think its contentious to say breaching a covenant of a loan agreement is a material indicator of the risk of a firm doing so again, and something an investor would want to know when assessing the appeal of investing in a certain company.

Crowdcube has said the explanatory note indicated the covenants relating to A's loan were in the process of being amended, and investors like Mr S were encouraged to do their own due diligence if they felt it necessary. Had he done so, he'd have discovered the previous breach.

There are various reasons the covenants may have been being amended – this may have been a periodic feature of the arrangement or something that happened at A's request. While Mr S could have sought more information, the issue at hand is whether simply stating the covenants were being amended was unclear or misleading. Given Crowdcube's knowledge of the reason for the amendments, I think it was.

The statement was given without comment or an indication as to whether this was a positive or a negative. Where the reason for the amendments was a breach – a technical event of default on A's part in respect of its loan – I think this represented a risk in relation to an investment in A which Crowdcube ought to have disclosed.

I acknowledge the breach was waived by B as part of the renegotiated loan agreement. But its willingness to do so again may well have been affected by the first breach. While Crowdcube clearly explained that there were conditions A had to satisfy in order to maintain

the borrowing from B, I think the risks of these conditions being met – and what impact a breach might have in future – were misleadingly underplayed by Crowdcube in its omission of the prior breach.

So overall I'm not persuaded Crowdcube communicated with Mr S in a fair, clear and not misleading way about his investment. It was aware of material information about A's history with regard to borrowing which the company needed to remain solvent. And, in my view, failing to mention this history meant Crowdcube failed to give Mr S the appropriate information to enable him to make an informed decision about whether to invest in A or not.

Crowdcube has argued I'm holding them to too high a standard by saying they should have considered the kind of information Mr S in particular would have wanted to know before investing. It says this isn't practical for a platform with many investors and many pitches.

But I'm not suggesting Crowdcube needed to tailor its communication to each individual investor's approach. What they did need to do was ensure the pitch was fair, clear and not misleading. As I've explained, including information about the loans A had access to, and the covenants attached, without revealing that A had previously breached those covenants, meant important context to the information Crowdcube provided was omitted. And it's not relevant whether this was information Mr S in particular needed or wanted. It was information that was, in my view, required in order to ensure the pitch was fully transparent about the benefits and risks of this particular investment. In other words, it was information necessary to ensure the pitch was fair, clear, and not misleading.

Did the omission affect Mr S's decision to invest?

Crowdcube has argued Mr S had invested in many companies on its platform before, and had never shown an interest in loan covenants or asked questions about them. But I'm not persuaded it's fair to conclude that just because Mr S had never asked about loan covenants before, he would not have appreciated the significance of A breaching them in the past. The question here isn't why Mr S didn't ask about loan covenants previously – it's how he wouldn't assessed this information when considering his appetite for investing in A.

And I'm persuaded by the evidence Mr S has provided, that he chose his investments carefully. He was clearly aware of the risks of investing in early stage companies – and crucially, he understood that such companies often rely on loans and other forms of credit in order to continue trading. I'm satisfied Mr S was prepared to take the risk in A based on what the pitch was telling him – that this was a company looking to grow into new products to expand its business. But the pitch was clear about the additional funding A would need in addition to the crowdfunding round. The crowdfunding was described as being there to "complement" the debt finance A had arranged, in order to allow it to grow and remain viable. I'm therefore persuaded that any potential risks that this additional funding might not materialise, would've altered the prospect of A not succeeding as a company.

In my view, information that showed that A had in the past not met loan covenants would've led Mr S to seriously consider the possibility that this might happen in future – and that therefore, future funding under A's arrangements with B might be in jeopardy. Given everything I've said above, and Mr S's testimony which I've found persuasive, I'm satisfied Mr S was not prepared to take that level of risk with his money. I'm persuaded that Mr S would've decided that investing in A with this history was not worth the risk, and he would've decided not to go ahead.

So I think Crowdcube should refund Mr S's investment into A, less anything he's received from the sale of the company. I'm also satisfied that seeing his investment fail has caused Mr S some upset, and I think Crowdcube should pay him a further £100 in light of that.

Mr S accepted my provisional decision. But Crowdcube didn't. In summary, it said:

- Crowdcube met its regulatory disclosure obligations, and it felt the pitch for A was fair, clear, and not misleading.
- The things Crowdcube disclosed were in line with requirements for similar regulated documents such as a prospectus.
- Many companies have matters which need to be addressed before they choose to promote investments in themselves. Here, A's renegotiation of its loan covenants with B was a condition of it having its pitch put on the platform.
- Where a matter like this is requested, and remedied, before a pitch is launched, Crowdcube wouldn't typically disclose it as it is no longer a matter affecting the company.
- This is similar to a company looking to list its shares on a UK exchange. The rules about what would need to be included in a prospectus in those circumstances say that things like historic loan covenant breaches don't need to be disclosed.
- It isn't fair to hold Crowdcube to an even higher bar than that, particularly where there are no specific regulatory rules to that effect.
- Crowdcube accurately described the loan to Mr S and informed him about the covenants attached to A's loan arrangement with B. Mr S was invited to ask further questions about the loan, but didn't do so.
- I was wrong to say Crowdcube had presented a misleading impression of the risks involved in investing in A. The key relevant risks here were that A had a loan involving certain financial covenants, that breaching those covenants would be an event of default, and that further tranches of the lending were dependent on separate revenue targets being met. Crowdcube disclosed all those things in the pitch.
- A's previous breach of a loan covenant wasn't an indication of the likelihood of A breaching any of the new covenants, as they'd been changed. Investors were told the bank and A had agreed a loan arrangement and it was for those investors to decide whether they had any concerns about it.
- I was wrong to say that the previous loan covenant breach was an indicator of the risk of A breaching a further covenant in future. The covenants were different so one had no bearing on the other.
- It wasn't consistent for me to say Mr S was careful in picking his investments, yet didn't make further enquiries about this investment.
- I conflated the covenant issue, concerning A's cash position, with the revenue target requirements linked to the release of further tranches of its borrowing. It isn't logical to say A was at risk of missing a revenue target because it previously breached a cash covenant.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

Having done so, I've not been persuaded to depart from my provisional conclusions, and so make those conclusions final here. I've thought carefully about Crowdcube's response to my provisional decision, and I acknowledge they disagree with my view on the importance of the disclosure of the loan covenant breach. But I remain of the view that failing to mention it meant the promotion failed to be fair, clear and not misleading. And that if it had included detail of the breach, Mr S wouldn't have invested. I say this largely for the reasons given in my provisional decision.

Crowdcube has said it wouldn't generally include information about previous covenant

breaches, variations of commercial contracts, or settlements of disputes where those matters are fully resolved before a fund raise. And it has noted that listing prospectuses don't include such information. I have thought carefully about these arguments, and reviewed my findings bearing in mind the relevant regulations which did apply to Crowdcube. As the business is right to point out, these regulations don't include prescriptive rules about what needs to be disclosed in a financial promotion. But they do say promotions need to be fair clear and not misleading.

This promotion contained numerous mentions of the loan arrangements between A and B. It is made clear that this lending was of fundamental importance to the company's viability, and therefore the risk that investing in the company presented.

The promotion details that the covenants were *"in the process of being amended"* and that failure to comply with the covenants could result in the loan facility being called in by B. I accept that the newly negotiated covenants may have been on different terms, and that not every background detail needs to be included in a promotion in order to make it clear and not misleading. But in these particular circumstances, where the promotion details that A was reliant on a lending facility involving covenants relating to A's cash position, I find that the promotion failed to give full context to the statements about the covenants without mentioning the previous breach, and wasn't fair, clear and not misleading as a result.

Even if the new covenant was different to the old one, and the previous breach had been set aside by B. The previous breach said *something* about A's ability to manage its finances in line with a lending arrangement, of a similar nature and with the same lender. I don't think the technical differences between the old and renegotiated covenants get away from the fact that the investment in A was promoted including details of a significant loan facility, yet a recent breach of the terms of that facility wasn't mentioned.

Overall I'm persuaded that Crowdcube didn't treat Mr S fairly as it promoted the investment in A to him in a way that wasn't fair, clear and not misleading.

I also still consider that, had the promotion included detail of the breach, Mr S wouldn't have invested. While Mr S may not have asked any questions about the loans or the covenant, I'm satisfied he invested on the basis of the promotion. For the reasons in my provisional decision, I think Mr S would have more likely than not acted differently had he known about the prior breach.

Putting things right

To put things right, Crowdcube should put Mr S in the position he'd have been in had he not invested. It should therefore refund to Mr S the amount he invested in A, less anything he's received from the sale of the company.

I'm also satisfied that seeing his investment fall in value has caused Mr S some upset. I consider £100 to be fair and reasonable compensation for that.

My final decision

For the reasons given here and in my provisional decision, I uphold this complaint. Crowdcube Capital Limited must pay Mr S compensation as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr S to accept or reject my decision before 28 April 2022.

Luke Gordon
Ombudsman