DRN-3304904

Financial Ombudsman Service

The complaint

Mrs G complains that Lending Works Limited changed its terms and conditions which allowed it to vary her interest rates on her loans held on its peer-to-peer ("P2P") crowdfunding platform in order to replenish its provision fund ("the Shield").

Mrs G says she would have withdrawn her investments before the changes were made had she known that Lending Works would eventually divert all her interest to the provision fund and subsequently enforce negative interest rates.

What happened

Mrs G held P2P lending accounts for a number of years on Lending Work's platform and invested funds in return for interest.

In January 2020, Lending Works changed its Lender Platform Terms and Conditions to allow it to vary the interest rates investors received on existing loans, in order for it to replenish the Shield – a segregated account used for the purpose of making payments to a lender when a borrower does not meet its obligations under a P2P agreement. Prior to this change, interest rates for ongoing loans were fixed. Lending Works also terminated an insurance policy, which had covered the Shield against some causes of default.

In April 2020, Lending Works emailed investors to explain that a Normalisation Period was being introduced in response to the Covid-19 pandemic. The Normalisation Period resulted in a pause on all new retail investors signing up on the platform, a pause on all new investments on the platform, as well as a suspension of the secondary market – a mechanism which allowed investors to sell their existing loans to other investors. Lending Works also introduced a 2% servicing fee in order to cover overheads associated with servicing the loan portfolio.

Lending Works also introduced a Lender Rate Adjustment under the changed Lender Platform Terms and Conditions to temporarily (initially for 90 days) divert all interest repayments to the Shield for all active loans on the platform. This meant that Mrs G received capital repayments only on her loans. The Normalisation Period and Lender Rate Adjustment was extended for an additional 90 days in July 2020 and again in October 2020. In November 2020, Lending Works emailed investors to explain that it was introducing negative interest rates due to the Shield requiring additional funding in order to protect investors. Lending Works also explained that it intended to resume lending and reopen to retail investors in January 2021 and that it would no longer be charging the 2% servicing fee once lending resumed. It also explained that the secondary market would remain suspended until further notice.
Following this, Mrs G raised a complaint to Lending Works regarding the changes it had introduced. In summary, she raised the following concerns:

- She didn't think it was fair for Lending Works to introduce the Lender Platform Terms and Conditions changes as she didn't receive the email notifying investors of the proposed changes. She said she would have withdrawn from her investments if she knew about the extent of these changes.

- She was initially attracted to investing on Lending Works platform because of the insurance policy it had in place for the Shield and she wouldn't have invested had she known it would be terminated.
- She didn't think it was fair for Lending Works to charge an interest shortfall – payable to investors purchasing loans from existing investors if the loan rate is lower than the current rates – considering the new Lender Platform Terms and Conditions were imposed on her without her say.
- She didn't think Lending Works had fairly reduced her interest as the Lender Platform Terms and Conditions were not clear as to the extent to which Lending Works would reduce this by.
- She was unfairly unable to withdraw her funds during the normalisation period and was unable to transfer her funds to an ISA, which caused her substantial distress and inconvenience.

Lending Works considered Mrs G's complaint and partially upheld her complaint. In summary, it said:

- It had emailed Mrs G on 28 November 2019 to notify her of the Lender Platform Terms and Conditions changes.
- The changes were in investors' best interests as the previous Shield mechanism was rigid and did not have the ability to flex along with the performance of the loan portfolio. This meant that if the Shield were to become depleted, then it did not have the ability to provide it with more funding.
- It allowed a period of more than 30 days before the changed were applied to allow any investors who did not wish to continue investing to use the secondary market in order to sell any outstanding loans to other investors. It confirmed that it would waive any fees which would have otherwise been payable to Lending Works during this window. These included the two fees charged when a secondary market transaction occurs – a fixed transaction fee payable to Lending Works and a variable fee payable to the investor purchasing the loan (this fee is only charged if the interest rate on a loan is lower than the Target Annualised Return at the time an investor sells the loan).
- Rather than allowing a deficit to build in the Shield, with the result that certain investors would be exposed to losses that would not be covered by the Shield, it decided it was in investors' best interests as a whole to divert interest into the Shield by varying the interest rate (eventually to a negative rate). It said this effectively spread the losses across all investors equally (in proportion to their investment) and avoided a situation where some 'unlucky' investors would be disproportionately negatively impacted.
- Between 2014 and 2019 the Shield had taken insurance cover at its own discretion to protect against some of the risks it was exposed to. The Lender Platform Terms and Conditions made it clear that the insurance cover was discretionary and that the Shield may cease to take insurance at any time. At the most recent insurance policy renewal, the protection relative to premium that the insurance offered resulted in the decision not to renew the policies and this directly benefited retail investors as it resulted in more funding being available in the contingency fund. Furthermore, the exclusions that the insurers introduced would have excluded most of the loans that defaulted during the Covid-19 pandemic.
- One of the main reasons for triggering a Normalisation Period was that it was concerned about the creditworthiness of borrowers since the Covid-19 pandemic began, and lending to customers that would not repay their loans would cause the Shield to come under greater pressure. In addition, the uncertainty regarding the creditworthiness of borrowers meant that it was difficult to price loans secondary

market loans accurately in a way which is fair to new investors buying and existing investors selling loans.
- Although Lending Works felt it had acted fairly and in line with its Lender Platform Terms and Conditions, it recognised the distress and inconvenience caused to Mrs G and offered £1,000 as a gesture of goodwill.

Mrs G didn't accept Lending Works' findings as she felt Lending Works ought to immediately release all of her invested funds with no penalty fees, reimburse all interest she'd had diverted to the Shield, reimburse all negative interest and provide substantial compensation for the distress and inconvenience caused. So she referred her complaint to this service for an independent review.

One of our investigators considered Mrs G's complaint and upheld it. In summary, he said he had concerns with how the changes were implemented and said Lending Works should put her back in the position had the change never been made. He also felt the offer of £1,000 for the distress and inconvenience was fair.

Following their initial view on the complaint, the investigator had extensive conversations with Mrs G and Lending Works and this resulted in it making a revised offer. Lending Works said that whilst it didn't necessarily agree with all of the investigator's findings, it didn't believe it would be wise in the circumstances to prolong the process for Mrs G any further and so it agreed to put her back in the position she would have been in had it not applied the negative interest rates.

It said that rather than modelling what would have happened if Mrs G's funds had remained invested at the fixed rate from November 2019 and applying any losses she would have incurred if the Shield hadn't had sufficient funds to cover any bad debt on her individual loans, it instead wouldn't consider loan defaults that might have applied and would simply look at the account balance as of November 2019 (the date on which the communication regarding the January 2020 changes was emailed to Mrs G) and refund any difference between that amount and the account as at the date the calculation is made.

There were some further discussions which led to Lending Works making the following revised offer to put things right for Mrs G:

- Pay Mrs G the difference between her account balances on 1 January 2020 and 31 March 2021 – ensuring any negative interest and fees are reimbursed.
- Pay Mrs G £1,500 in compensation for the distress and inconvenience caused.
- As Mrs G has outstanding loans on the platform that she's currently unable to sell, it agreed to pay Mrs G a lump sum to cover all expected future fees associated with these loans and committed to cover any future shortfall.

Mrs G didn't accept this offer as she said her losses from the reduced interest rates should be calculated based on the 6% target interest rate over the full five-year term. She felt the changes Lending Works introduced forced her to make withdrawals and she lost the opportunity to earn 6% over the full term of her investments.

The investigator considered Lending Works' offer to be fair and explained why he didn't think it needed to calculate the offer on the basis Mrs G had proposed. In summary, he said:

- Where a business done something wrong, our service aims to put the customer back in the same position they'd be in if the wrongdoing never happened.

- If Lending Works had never introduced variable rates, then the Shield would have likely run out of funds, based on the rapidly decreasing balance in 2019. And so, Mrs G would have likely suffered significant capital losses.
- Putting her back in the same position as if the change was never made means comparing her actual return to a hypothetical scenario where the Shield ran out of money – and so couldn't cover all, if any, missed payments or defaults in her portfolio.
- 6% was only a target rate and was always subject to change based on the performance of her portfolio and even with the Shield in place, if a borrower defaulted the Shield would only repay the capital - not the anticipated interest over the life of the loan. And so she was always at risk of not making the target interest rate.

As no agreement could be reached, the complaint was passed to me to decide.

I issued my provisional findings on the matter in June 2023. I include a copy below:

What I've provisionally 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.

It's clear how strongly Mrs G feels about her complaint. I want to assure her that I've carried out an independent review and considered everything that both parties have submitted. We provide an informal complaints handling service as a free alternative to the courts and this is reflected in the way I've approached the complaint. It's part of my role to identify and concentrate on the core issues I need to address in order to reach a fair outcome – this means I might not mention everything Mrs G has said, but I will comment on everything that makes a difference to the outcome of the complaint.

Whilst there still seems to be some dispute as to whether Lending Works acted fairly in introducing the changes to the Lender Platform Terms and Conditions, considering it's agreed to compensate Mrs G, my decision will focus solely on whether Lending Works' offer is fair and reasonable in all the circumstances.

I think it would be helpful for me to start by explaining why I don't think Mrs G's proposed settlement is fair. Mrs G believes that she ought to be entitled to 6% interest on her investment over the full five-year term.

This service's starting point for redressing complaints is to try and put the consumer back in the position they would have been in if the changes hadn't happened. Whilst I don't think it's necessary in this case to comment on Lending Works' decision to make the changes, in determining whether Lending Works' offer is a fair one, I do need to consider what is likely to have happened to Mrs G's investment had the changes not been made.

Lending Works has provided statements showing the balance of the Shield and from these it's clear that at the time of implementing the changes, funds in the Shield were depleting. The changes were introduced shortly before the Covid-19 pandemic began, which had a significant impact on lenders abilities to make repayments. I think it's reasonable to say that Lending Works lenders would have been impacted by this and on balance, it's likely, given the time Mrs G had been investing on the platform and the diversification of her portfolio that losses would have applied to her account had the Shield not been topped up by the diversion of interest. Whilst I'm not able to say with any certainty what the extent of her losses would have been, given that Lending Works has explained that the Shield would have been fully depleted during the Covid-19 pandemic had it not made the changes, it's more than likely that, in this scenario, she wouldn't have been able to achieve the 6% target *interest rate. The investigator who considered Mrs G's complaint provided her with some calculations which suggested that she had received more in payments from the Shield than she sacrificed in negative interest and so it's clear Mrs G did benefit from the Shield being in place. It's also worth noting that the 6% rate was only a target rate and was always subject to change based on the performance of her portfolio and even with the Shield in place, if a borrower defaulted the Shield would only repay the capital - not the anticipated interest over the life of the loan. So taking into account all of the above, I don't think it would be fair for Lending Works to compensate Mrs G in line with her proposed settlement.*

Turning to Lending Works' offer, I've thought carefully about whether the offer is fair. And having weighed up everything, I'm minded to make a finding that the offer is fair and reasonable in all the circumstances. I'll explain why.

Lending Works offer is essentially to put Mrs G back in the position had the negative interest changes not applied. However, Mrs G's initial submissions made it clear that had she known about the full extent of the changes and how it would impact her, she would have exited from the platform in November 2019. In which case, it could be argued that a fairer and more reasonable outcome would be to put Mrs G back in the position she would have been in if she'd tried to exit the platform in November 2019. However, it's unclear as to when she would have been able to exit. I understand there wasn't much demand for buying other investors' loans on the secondary market during this time due to the influx in investors looking to exit the platform. Furthermore, compensating Mrs G in this way would mean that she wouldn't have benefitted fully from the interest she subsequently received on her loans, albeit her interest was reduced prior to the full interest diversion in April 2020 and negative interest rates being introduced in November 2020.

In the previous scenario, I would need to consider what Mrs G would have done with her funds had she not remained invested on the platform. Mrs G has mentioned potentially investing the funds into an ISA. ISA rates at the time were much lower than the interest she was receiving prior to the changes in April and November 2020 and so it's unclear whether she would have been in a better position in this scenario than the offer Lending Works' has proposed – especially considering it's uncertain when she would have been able to sell her loans and been able to invest these funds elsewhere.

I've also considered that even if Lending Works hadn't made the changes it did, Mrs G wouldn't have made the returns she'd hoped for, for the reasons I've explained. While it's impossible to precisely recreate what her investments would have done and when the Shield would have paid out, I've considered that it's possible that the level of defaults on her loans would have left her worse off than she now is. And certainly worse than the position Lending Works' offer seeks to put her in.

Similarly, had Mrs G left the platform (at a time when markets were about to become very volatile as the Covid-19 pandemic hit), there's also no persuasive evidence I've seen that she'd have been likely to make a substantially positive return (especially net of the fees she'd have likely had to pay to exit the platform and possibly to enter new investments). Taking all that into account, I'm satisfied Lending Work's offer is fair and reasonable given everything that's happened. Overall, I do think Lending Works' offer strikes a balance between Mrs G not being exposed to the negative interest changes, whilst allowing her to benefit from some interest during a time of economic uncertainty. The offer also allows Mrs G to exit from the platform without incurring any fees associated with doing so. I also think the offer of £1,500 does fairly take into account the considerable distress, upset and worry caused to Mrs G.

<u>Responses to my provisional findings</u>

Lending Works accepted my provisional findings, but Mrs G didn’t. In summary, Mrs G said:

- My provisional findings failed to address her complaint point that she was mis-sold the investment product in 2017.
- Lending Works’ offer is unfair as it compensates her as if she was effectively put on a 0% interest rate between 1 January 2020 to 31 March 2021. However, this means she misses out on all of the variable, positive interest earned between 1 January 2020 and 5 April 2020 (when the 0% interest rate was introduced).

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.

I hope Mrs G doesn’t take it as a discourtesy that I won’t be responding to each submission or every point she has raised. The purpose of my decision isn’t to do that, but rather to explain my findings on the key issue, which is whether Lending Works’ offer is fair and reasonable.

<u>Mis-sale points</u>

I understand Mrs G has raised concerns regarding the overall product being mis-sold to her. She says Lending Works misled her about the level of diversification her invested funds would benefit from and that an insurance policy would provide further protection. These mis-sale arguments have been made in addition to changes Lending Works’ made which Mrs G feels were unfairly introduced. As I mentioned in my provisional findings, as Lending Works has made an offer, my decision will focus on whether Lending Works’ offer is fair and reasonable in all the circumstances. To be clear, this offer is in respect to changes introduced by Lending Works and not in relation to the overall investment product being mis-sold. However, I will briefly explain why I have no concerns regarding the information provided to Mrs G before she decided to invest.

Lending Works was authorised and regulated by the Financial Conduct Authority (“FCA”). The relevant rules and regulations FCA regulated firms are required to follow are set out in the FCA’s Handbook of rules and guidance. The FCA Principles for Business (“PRIN”) set out the overarching requirements which all authorised firms are required to comply with. The most relevant principle here is:

- PRIN 2.1.1R (7) “A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.”

Lending Works was also required to act in accordance with the rules set out in the Conduct of Business Sourcebook (COBS). And the most relevant obligation here is:

- COBS 4.2.1R (1) “A firm must ensure that a communication or a financial promotion is fair, clear and not misleading.”

So Lending Works was required to provide Mrs G with information which was fair, clear and not misleading, in order to allow her to make an informed decision on whether the account was something that was right for to invest in.

In regard to the insurance policy, as I mentioned in my provisional findings, the Lender Platform Terms and Conditions made it clear that the insurance cover was discretionary and that the Shield may cease to take insurance at any time. So I don't agree Lending Works misled her here.

Turning to her point about diversification. Mrs G says that Lending Works' website stated:

> *"…with Lending Works you'll be diversified to the maximum possible extent."*

Mrs G says her understanding of this was that between £0.01 and £1.00 of her invested funds would be put into any given loan part but she has since found out that up 10% of her funds could be invested. Whilst I agree that Lending Works could have provided further clarity around the level of diversification, I don't think the absence of such information necessarily renders the information misleading. Furthermore, if the level of diversification was crucial to Mrs G's decision to invest with Lending Works then I would have expected her to clarify this with it before proceeding to invest.

So taking into account all of the above, I've not seen anything to support that Mrs G was given misleading information regarding the insurance policy and diversification when she first decided to invest with Lending Works.

<u>Lending Works' offer</u>

I explained in detail why I felt Lending Works' offer was fair and reasonable in all the circumstances and I don't think it's necessary to expand on my findings further, other than to clarify to Mrs G why I'm not recommending Lending Works compensates her further for any positive interest earned between 1 January 2020 and 5 April 2020.

As I mentioned in my provisional findings, Mrs G initial submissions made it clear that had she known about the full extent of the changes and how it would impact her, she would have exited from the platform in November 2019. And so to put her back in this position would mean that she wouldn't have earned any interest from November 2019 onwards. However, Lending Works offer allows her to essentially keep any interest earned from November 2019 to January 2020. Whilst Mrs G thinks she should also benefit from positive interest earned from January to April 2020, on the whole, I feel Lending Works' offer strikes a fair balance between her not being exposed to the negative interest changes and allowing her to benefit from some interest during a time of economic uncertainty, which she wouldn't have been entitled to had she exited in November 2019. The offer also allows Mrs G to exit from the platform without incurring any fees associated with doing so.

I also think the offer of £1,500 does fairly take into account the considerable distress, upset and worry caused to Mrs G.

Putting things right

I think Lending Works offer is fair and so I intend to instruct it to do the following, if it hasn't already:

- Pay Mrs G the difference between her account balances on 1 January 2020 and 31 March 2021 – ensuring any negative interest and fees are reimbursed.
- Pay Mrs G £1,500 in compensation for the distress and inconvenience caused.
- As Mrs G has outstanding loans on the platform that she's currently unable to sell, it should pay Mrs G a lump sum to cover all expected future fees associated with these loans and take an undertaking to cover any future shortfalls that may arise.

My final decision

My final decision is that Lending Work Limited's offer is fair and reasonable in all the circumstances and it should compensate Mrs G in line with this.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs G to accept or reject my decision before 12 October 2023.

Ben Waites
Ombudsman