

## **The complaint**

Mr B complains that Funding Circle Ltd provided misleading information when he invested in a peer to peer (P2P) opportunity it promoted on its platform. He says the security for the loan was misrepresented and as a result he has suffered a financial loss.

## **What happened**

Funding Circle provides a loan-based crowdfunding facility through a P2P platform in which investors can lend to borrowers in return for interest with capital returned at the end of the term.

Mr B has been a lending member on Funding Circle's platform since 2011, and has invested in multiple different loans over a number of years. Mr B continued lending on the platform until April 2017 – after this he made no further investments.

In the particular loan subject to this complaint, Mr B invested a total of £1,000 across four tranches of the loan in 2016. He said he has been raising concerns about the loan since 2018. He made a formal complaint in November 2021 in an attempt to recover his losses.

Funding Circle responded to the complaint but did not uphold it. In summary it said:

- The Investor Report (IR) is clear that the loan was only to fund the development building.
- It accepts the report could be clearer in describing the property versus the development site however, it disputes that this would have affected an investor's decision to invest.
- It strongly disputes that the IR was misleading.

Mr B didn't agree with the response, so referred his complaint to this service for independent review. In his submission to this service he reiterated his concerns about misrepresentation of the security, both in terms of the value of it and the personal guarantee provided. He also raised concerns about how Funding Circle monitored the loan and carried out its role as managing agent.

One of our investigators looked into the complaint. She upheld it as she identified failings by Funding Circle that she felt would have led to Mr B making a different decision to invest. In summary she said:

- Funding Circle provided misleading information within the loan promotion about the value of the security. The promotion indicated that the security was for the whole site, but Funding Circle has since clarified this it is only for the development property (and not the other buildings on the site).
- The investigator was persuaded by Mr B's testimony that he relied on the information in the promotion relating to the security before deciding to invest. She was persuaded by Mr B's explanation of why he relied on the £1.6 million sale price, rather than the £2 million valuation of the development property, when he decided to invest.
- She was also satisfied that, if the true position had been made clear, Mr B wouldn't have invested as a reduction in his understanding of the value of the security would have made a difference to his decision to invest.

- She recommended Funding Circle compensates Mr B by comparing the position if he hadn't invested in this opportunity with what he would have received from the average returns on similar property loans of the same risk profile that were available on the platform.

Funding Circle didn't agree with the investigator's conclusions. In summary it said:

- Mr B allegedly based his investment decision on the 2015 sale price of the whole site. However, the value of the development property represented approximately 89.5% of the value of the whole site – not a third of the value as has been assumed. It is confident that given the value of the development property, Mr B would still have invested in this loan had the true position of the security been clearer.
- Mr B's claim that he would not have invested in this development is made only with the benefit of hindsight. There is always a risk the proceeds after enforcement may not be enough to discharge all obligations by the borrower to lenders on the platform. It has always been clear that security does not equal repayment and it never guarantees repayment as when lending through Funding Circle, an investor's capital is at risk.

Mr B provided further submissions to the points raised by Funding Circle. In summary he said:

- Funding Circle are liable for a serious breach of the Misrepresentation Act 1967 and doesn't accept that he is making an argument with the benefit of hindsight.
- He didn't continue to invest in these loans up until 13th April 2017, all of investments were made between May and July 2016.
- He questions how Funding Circle was able to promote a loan for the other buildings on the site if his understanding of the original security is correct - without weakening the original security.

As no agreement could be reached the complaint has been passed to me to make a decision.

### **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.

Through his P2P account, Funding Circle provided Mr B with the opportunity to invest in the loans it was promoting on its platform. Mr B selected to invest in this loan based on the information he saw on the platform. I've reviewed the relevant investor terms and conditions that applied when Mr B invested as they form the basis of this relationship.

In reaching my decision, I've also considered Funding Circle's wider obligations. At the time of promoting loan one on its platform, Funding Circle was authorised and regulated by the 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. PRIN 1.1.1G, says *"The Principles apply in whole or in part to every firm"*. The Principles themselves are set out in PRIN 2.1.1R. The most relevant principles here are:

- PRIN 2.1.1R (2) *"A firm must conduct its business with due skill, care and diligence."*
- PRIN 2.1.1R (6) *"A firm must pay due regard to the interests of its customers and treat them fairly."*

- 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.”*

Funding Circle was also required to act in accordance with the rules set out in the Conduct of Business Sourcebook (COBS). And the most relevant obligations here are:

- COBS 2.1.1R (1) *“A firm must act honestly, fairly and professionally in accordance with the best interests of its client.”*
- COBS 4.2.1R (1) *“A firm must ensure that a communication or a financial promotion is fair, clear and not misleading.”*

So, before making the loan available on the platform for investment, Funding Circle needed to satisfy itself that the information it collected and used to promote the loan was fair, clear and not misleading. And it also needed to be satisfied that by providing an opportunity for its customers to invest in the loan it would continue to be acting in its client's best interests.

In order to satisfy itself of the fair, clear and not misleading nature of the claims or assertions made in the promotional material itself, Funding Circle would need to carry out reasonable checks. What these reasonable checks involve, or indeed what they might be in any given case, is something which is very much left to each provider to determine and would vary according to the particular circumstances.

I've also borne in mind that the FCA said the following in its July 2018 consultation paper on loan-based ('peer-to-peer') and investment-based crowdfunding platforms:

*“It is our view that it will be unlikely that a platform could argue that it has met its obligations under Principle 2, Principle 6 (PRIN 2.1.1R) and the client's best interests rule (COBS 2.1.1R), if it has not undertaken enough due diligence to satisfy itself on the essential information on which any communication or promotion is based.”*

Whilst I appreciate Mr B had invested prior to the publication of the consultation paper and guidance, I still feel it is relevant as it provides clarity as to the interpretation and application of the existing rules and guidance which were applicable to Funding Circle at the time.

I've considered the circumstances surrounding the promotion of this loan – paying particular attention to the IR as this was the information Funding Circle provided to set out the details of the opportunity, and from which Mr B made his investment decision.

This is a property loan on a building with residential and commercial units – which was part of a site containing three adjacent buildings. Only one of the buildings was to be developed using the crowdfunding for the loan – I'll call this the “development building” and the other two buildings I'll call “other building H”, “other building C” or “the other buildings” for ease of reference. One of the key considerations and points Mr B has raised relates to how the security was described in the IR.

I've considered whether Funding Circle provided clear, fair and not misleading information to Mr B about the security before he first invested in the loan. The IR describes the security as 1<sup>st</sup> legal charge. In the summary it says:

*“The borrower purchased the property in 2015 for £1.6m with the help of a bridging loan and has also funded the costs of gaining the planning permission.  
The subject property comprises 3 buildings:*

- The [development building], with primary frontage onto [X Street]
- [other building H]
- [other building C]

*While the planning permission allows for the development of [other building H] and [other building C] as well, at this stage FC investors are only being asked to fund the redevelopment of the [development building].”*

And when describing the site it says:

*“All three buildings are situated within the [a] Conservation Area, with [other building H] and [other building C] being Grade II listed. The properties have a GIA of c32,000 sq ft and other than the commercial units (which have been let to secondary tenants) have been largely vacant and disused.”*

And when referring to the value it says:

*“We have received an independent valuation and monitoring surveyor report validating the following figures:*

*Current site value £2,000,000*

*GDV £5,447,375*

*Development costs (incl contingency) £1,700,000*

*The GDV of £5.447m mentioned above breaks down as follows:*

- *The value of the resi units total £4,497,375 (breakdown per flat in the table below)*
- *The commercial units have been valued at £685k*
- *The freehold has been valued at £265k.*

*The total value is thus £5,447,375 as mentioned above.*

*The resi units plus the freehold have been pre-sold for £4,376,500, with the resi units having been sold at 10-20% discounts to their OMV as is normal for pre-sales of this nature. As we have security over the whole site we have based our ratios on the £5.447m GDV figure, but it is comforting to know that the resi units alone cover the proposed debt more than 1.5x.”*

In its submissions to this service Funding Circle has confirmed the security over the whole site, means the development building only – and not the other buildings detailed in the IR. So the charge it held was over that building only. Funding Circle maintains the information in the IR was clear in stating the loan was only to fund the development building. And the key loan features table which detailed that the security obtained was a first legal charge only referenced the development property address. But it concedes the IR could be clearer in describing the property versus the development site.

But I'm not persuaded things are as clear as Funding Circle suggest. The IR is clear that the funding is for the development of only one of the buildings – but all the way through it mentions the site contains three buildings. There is a clear reference to having security over the whole site too – this provides a strong suggestion that the security isn't limited to one building but rather all three it describes throughout the promotion. The use of the terms “site” and “building” is informative, so I think this would lead a reasonable person to consider “site” to mean all three buildings and “building” just means the one being developed. I don't think it reasonable to rely solely on the information in the key features table makes the security clear, when the other information doesn't make it clear the security is only the development

property. The IR also provides a visual description of the site using a map, which highlights all three buildings. If two of the buildings weren't considered to be part of the site or security, I wouldn't have expected them to be mentioned and highlighted so prominently. I'm also aware of an extract from the Q&A section on the loan profile from Funding Circle's website, which contains a comment from Funding Circle saying "*security will include a first charge over the entire development site.*" This again gives the impression the security for the loan isn't just the development property but rather the whole site.

While I appreciate Funding Circle says the security was always over just the development building, the IR doesn't make this clear. This is something I would have expected to have full clarity about, so investors like Mr B could make an informed decision before they became lenders. Having considered the information provided to Mr B before he invested, I think it was reasonable for him to understand the security to be the whole site when he decided to invest. Having considered all of the evidence provided, I've reached the finding that the information Funding Circle provided about the security wasn't. For these reasons, I think it failed to meet its obligation to provide clear, fair and not misleading information to Mr B.

I need to decide whether the failure to provide clear information about the security would have made Mr B make a different decision on whether to lend. The value of the security is a very important piece of information as it allowed Mr B to understand the protection available should the loan not perform as expected.

Funding Circle has argued that the value of the development building was clear in the IR. So, despite the concessions made about the wording used in the IR, it still thinks Mr B would have been aware of the value of the security. It says the £2 million value detailed on the IR was for the development property and not the whole site. It says whether the security was over one building or three, investors invested in this loan on the basis that the security was valued at £2 million and this is what is relevant.

Mr B says at the time of this investment he was a regular lender to property development loans. He says he understood once the project commences, all the money that is spent developing it is at risk until the project is completed - and if the project fails, there is very little market demand for part-completed building projects. So, part-completed projects are often worth no more than the un-renovated original plot. For this reason, when he made decisions to invest in loans, he considered what he might receive back if the worst case happens and the project fails part way through. He seeks to understand the unrenovated site value plus any other security offered (in this loan a personal guarantee from the director). He says he reasonably understood from the IR, that the loan security was the whole site of comprising of three buildings bought in late 2015 for £1.6 million plus the director guarantee. On this basis he decided this to be reasonable security to proceed to lend.

I'm satisfied that Mr B has made a plausible argument for his decision to invest based on the information contained within the IR. In response to the investigator's findings, Funding Circle has provided one main argument for why it doesn't think clearer information about the security would have made a difference to Mr B's decision to invest. It says Mr B would still have invested in the loan had he been aware that the true position of the security, because the development property represented 89.5% of the value of the whole site. It has calculated this value using the predevelopment valuation it obtained on the different buildings and made some assumptions to calculate this percentage. It says there is an assumption that the value of the security was reduced by two-thirds as it only held security over one of the three buildings on the site. But it has calculated the value of the development building represented significantly more of the value of the whole site. It says given this; Mr B would still have invested if the position on the security was clearer.

The key point Funding Circle is making here is that the development building represented virtually all of the value of the whole site, so the unclear information in the IR about the security wouldn't have impacted Mr B's decision to invest. But I don't think the assumptive figure of 89.5% is clear cut as Funding Circle has suggested. It has relied on separate valuations of the properties completed a year apart rather than an evaluation of the whole site done at once. It has also used an assumed regional increase in property prices in the intervening year between valuations. Funding Circle say it believes there is an assumption that the value of the security was reduced by two-thirds to £500,000 due to the security only being over one building on the site. The figures Funding Circle use here aren't something that has been mentioned by Mr B. But regardless the unclear information in the IR means there was still a reduction in his understanding of the value of the security – exactly by how much is less clear. I understand the argument Funding Circle make but, in my view, there is uncertainty about the comparative valuations it presents. And the reasons Mr B has given for his investment decision mean I don't think it is a strong enough argument to say Mr B would still have invested despite the information failings I've identified.

Overall, the question of whether Mr B would likely have still invested is finely balanced. But clear information about the value of the security is something that I'm satisfied would have been very important to his decision to invest. Having considered the arguments put forward, I've reached the conclusion Mr B wouldn't have invested if he had been given clearer information.

Mr B has made other arguments why he believes Funding Circle failed to provide clear information and also failed to manage the loan correctly contributing to the losses he suffered. I haven't needed to reach a conclusion on these points - because - for the reasons explained above - I've found a reason why the complaint should be upheld.

To confirm, for the reasons described above, I find that Funding Circle failed to provide Mr B with clear, fair and not misleading information when promoting this loan. But for these failings, I don't think Mr B would have invested in this loan. I uphold this complaint.

### **Putting things right**

To compensate Mr B fairly, Funding Circle must:

- calculate how much Mr B has received back from his initial investment into the loan - including any interest and funds that have been recovered and returned to him (A) - the actual value;
- then calculate how much Mr B would've received had he received an \*average rate of return for A+ rated loans (excluding the loan subject to this complaint) across the platform from the date he invested in the tranches of the loan until the date in May 2017 the loan was due for repayment (the end date) \*\* (B) - the fair value.

If B is greater than A, Funding Circle should pay Mr B the difference. It should add additional interest at a rate of 8% simple per year on any loss from the end date to the date of settlement. If A is greater than B, then Mr B hasn't suffered a financial loss and there will be no financial compensation to pay.

\* The average return means the net return – so incorporates positive performing loans and any default rates.

\*\* Funding Circle has confirmed Mr B stopped investing in the platform in April 2017, I think it's reasonable to assume he wouldn't have invested further on the platform after his funds

from this loan were due to be repaid in May 2017, so any loss should be crystallised from this point.

### **My final decision**

For the reasons set out above, I uphold this complaint. My decision is that Funding Circle Ltd should pay the amount calculated as set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr B to accept or reject my decision before 16 June 2023.

Daniel Little  
**Ombudsman**