

Complaint

Mrs H complains about the way Funding Circle Ltd has administered the account she holds on its peer to peer lending platform. She is unhappy that when Funding Circle introduced a change in the terms for her account, it prevented her from accessing information on its platform because she didn't agree to the new terms. She also complains about the way loans were promoted and managed on the platform. Specifically, she has raised concerns about the six loans being misrepresented and failings in the recovery actions by Funding Circle when they went into default.

Background

Funding Circle provides a loan-based crowdfunding facility through a peer to peer platform in which investors can lend to borrowers in return for interest.

Mrs H has been a lending member on Funding Circle's platform since 2015 and has invested in several different loans over a number of years. In August 2017, Funding Circle announced a change in the terms and conditions to accounts on the platform, which it planned to introduce the following month. The new terms included a material change to the way loan parts were allocated - moving from a manual process where lenders select loans to an automated process. Mrs H didn't accept the new terms.

In August 2018, Mrs H complained to Funding Circle as she could no longer access information on the platform, which she needed to allow her to manage her investment. Funding Circle responded to the points Mrs H raised in September 2018. It didn't uphold the complaint. In summary it said it wouldn't provide her with access to the website, the platform or her account without accepting the new terms and conditions but would provide a monthly update and manually send any available funds to a bank account.

Mrs H wasn't happy with the response, so referred her complaint to this service. In July 2019, Mrs H contacted Funding Circle asking for specific information relating to six loans that she had concerns about. Specifically, she asked for information on the initial promotions, securities in place and recovery actions. This information gave her reason for concerns about mis-representation in the promotion of the loans and failings in the recovery actions taken by Funding Circle.

One of our investigators looked into the complaint but didn't uphold it. Essentially, the investigator didn't find Funding Circle had treated Mrs H unfairly by not providing access to the website – and he also didn't find any failings in the way the loans had been promoted and administered. Mrs H didn't accept the investigator's opinion and requested an ombudsman reach a decision.

After further investigation and discussion with Mrs H, she confirmed that she didn't require an ombudsman to reach a decision on her complaint point about blocking access to her account. She explained the concerns she would like the ombudsman to focus the decision on were those she raised about two of the loans "loan one" and "loan four."

After further discussions with this service, Funding Circle agreed to make Mrs H an offer in respect of loan four. This offer was put to Mrs H and she accepted it as a resolution of her complaint about this loan. This left the issues Mrs H had raised about loan one as the only part of the complaint unresolved.

I issued a provisional decision in June 2021 – I said I intended to uphold the complaint.

This is what I said:

“Firstly, I’ve considered Funding Circle’s role and relationship it has with investors, as well the regulatory and legal framework involved. To determine this complaint, it’s important to understand the role and relationship Funding Circle has with Mrs H as an investor.

I’ve reviewed the relevant investor terms and conditions that applied when Mrs H invested as they form the basis of this relationship. These explain the overarching relationship is that Funding Circle provides potential investors with different lending opportunities by way of presenting loans available for investment on the platform, but it gives no advice or recommendations to its investors.

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 Mrs H 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.

Taking the above into account - I've firstly considered how Funding Circle has acted, focussing on how loan one was promoted.

Loan one was a short-term property-based loan on a building with residential and commercial units. Mrs H raised concerns about how the security was described. There are three adjacent buildings that form the focus of the issues surrounding the nature of the security. Only one of the buildings was to be developed using the crowdfunding for loan one – 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. I've considered whether Funding Circle provided clear, fair and not misleading information to Mrs H about the security before she first invested in the loan at the end of July 2016. The investor report was the main document available to Mrs H - this describes the security as 1st legal charge. In the introduction 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:

"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."

There are also pictures within the document that mark the site – and includes all three buildings.

Mrs H also provided information that she received from the Q&A section of Funding Circle's website that allowed potential investors to ask questions about the proposal. This includes the following:

"Q. 6 May 2016 14:26 - FC Comment: please note that this is a property development loan, for which further information can be found in the investor report and relevant section of the terms and conditions document (accessible in the financial summary tab). It is the second of multiple loans for this project, with the total funding requirement estimated to be £2.824m. Please also note that the repayments for this loan are interest only, with the principal to be repaid in full at the end of the 12 month term. Furthermore, no financials will be displayed for this company, as they are not considered relevant to property developments. Finally, security will include a first charge over the entire development site. Thanks, FC."

During our investigation we asked Funding Circle to clarify information on the security. It confirmed that the investor report for loan one correctly describes the security as for the whole site – i.e. all three buildings. It also confirmed the value of the site in the investor report is the value of all three buildings (as opposed to just the value of the development building).

Subsequent to providing the above confirmations, Funding Circle has changed its position and says when it refers to the security over the whole site, it means the development building only – and not the other buildings detailed in the investor report. And the loan was for the development building only, and so it only held a charge over that building.

Mrs H says the information provided by Funding Circle led her to believe that the security held was for the whole site (i.e. all three buildings) and this was an important factor in her lending decision. She also provided an extract from the land registry for the development building – which she says carves up the security across the site shortly after she invested.

During our investigation we asked Funding Circle to comment on whether the security on the development building was impacted in anyway by lending on the other two buildings. It said the security for loan one was not impacted as the loans in respect of the other two buildings were secured by different charges over different properties.

It has been established that Funding Circle did promote and crowdfund a loan in January 2017 to redevelop the other two buildings on the site. Funding Circle says that this loan was wholly separate to the loan subject to this complaint. And while the borrowers had the same director, they are separate legal entities and applied for separate loans via the platform. It also says the security on the second loan was provided over a specific building.

Having considered everything that has been provided by the parties during our investigation – I am minded to reach a finding that Funding Circle failed to meet its obligations when providing information to Mrs H. It has been difficult to gather clarity about the security and at times Funding Circle has provided contradictory information. The fact information remains unclear, is a strong reason to say the information originally proved to Mrs G can't be considered clear, fair and not misleading.

The investor report is the key document provided to investors. The report is clear that the development taking place is funding the development for 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 development through this crowdfund. The report 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. The Q&A extract also supports the position that the security for the loan was over the whole site. This would have been another opportunity for Funding Circle to provide clarity over the security to allow investors to understand what they were investing in. Funding Circle have now suggested the security was always over just the development building but there is nothing in the investor report to make this clear. If this was the case, then I would have expected this clarity to be given to investors like Mrs H before they became lenders. The fact Funding Circle have provided contradictory information about the security during our investigations, further supports that the nature and value of the security wasn't clear. Having considered the information provided to Mrs H before she invested, I think it was reasonable for her to understand the security to be all three buildings when she decided to invest.

Funding Circle says it didn't mislead Mrs H and refers back to there being separate loans for the buildings made to separate entities. And also, the security taken for each loan was completely separate as legal charges were taken over two separate title numbers registered at the land registry. Mrs H has provided two entries from the land registry (which appear to be the entries that Funding Circle is referring to). The first relates to the development property for this loan. This contains an extract that suggests a change was made that mentioned the other buildings on the site – it says:

"The land has the benefit of any legal easements reserved by a Transfer of [Other building C] dated 9 March 2017 made between (1)[Borrower L] Limited and (2) [borrower C] Limited but is subject to any rights that are granted by the said deed and affect the registered land."

The two entities (Borrower L and Borrower C) referred to are the borrowers for the loans Funding Circle promoted. And the address title mentioned is one of the other buildings referred to in the investor report for loan one. Mrs H says this is evidence that the security over the whole site was carved up and a separate security for the other buildings was created. She supports this statement by providing a second entry from the land registry. This is for a title that was created in March 2017 (so shortly after loan one was drawn down) – and contains the same information about legal easement of transfer. She says that if it was always the intention to change the security, then this should have been made clear. I haven't been able to establish if the security was carved up as Mrs H suggests but I can understand why she is concerned that this may have happened. But at this point, I don't think I need to make a firm finding on this. The uncertainty around the securities for the different buildings means that Funding Circle's arguments don't persuade me that the investor report for loan one was clear.

If Mrs H is correct and the security was diluted in early 2017, then this brings into question whether Funding Circle is correct in its position that the security was only ever for the development building. And raises further questions about the information used to promote

loan one. If the security has changed, I think it would have been reasonable to expect the likelihood of this happening to be made clear to investors for loan one when it was promoted. I say this considering the short proximity between the two loan promotions and the involvement of Funding Circle with linked borrowers (i.e. same director) for both loans. If the security was changed shortly after loan was promoted - then I'm likely to reach the same conclusion (for a different reason) that Funding Circle failed to provide clear information.

Having considered all of the evidence provided, I've reached the finding that the information Funding Circle provided about the security was at best unclear, and at worst misleading. For these reasons, I think it failed to meet its obligation to provide clear, fair and not misleading information to Mrs H.

I need to decide whether the failure to provide clear information about the security would have made Mrs H make a different decision on whether to lend. The value of the security is a very important piece of information as it allowed Mrs H to understand the protection available should the loan perform as expected. The unclear information makes it difficult for Mrs H to understand the value of the property the loan has security over. The investor report gives an undeveloped, "current site" value of £2 million (and also the purchase price in 2015). Mrs H says this was information she used to make her decision to invest and used this to as a reasonable guide (and better than the development value listed) to real value at the outset. Funding Circle say that the security was only for the development building and not the whole site – so not including the other buildings. This being the case, Mrs H doesn't have clarity on whether this value is for just the development building or all three buildings. A change (specifically a reduction) in her understating of the value of the security is something I'm satisfied would have made a difference to Mrs H decision to invest. It follows that I don't believe Mrs H would have invested in loan one, but for Funding Circle's failure to give her clear information about the security.

Mrs H has set out other reasons why she believes Funding Circle failed to provide clear information and also failed to manage the loan correctly contributing to the losses she suffered. At this stage 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.

Therefore, the rest of my decision is concerned with what I think is a fair and reasonable way to put Mrs H back in the position had she not invested in loan one.

Putting things right

As I've reached the finding that Mrs H would not have invested in this loan, I next need to decide what she would have done with the money she invested. I think it likely that she would have invested in further crowdfunding opportunities. I'm satisfied that she had an interest in using Funding Circle's platform as a way of seeking a return on her money. It's difficult to know exactly what other loans she would have invested in – as that would depend on what other loans were available.

Proposed redress calculation

Having carefully considered all the available information and evidence, I currently think the fairest way to compensate Mrs H is to assume a rate of return that is equal to average return on loans of a similar risk profile on Funding Circle's platform. I say this because I'm satisfied that Mrs H would have continued to invest on the platform, but I take the view that she would have invested differently. It is not possible to say precisely what she would have done

differently. But I am satisfied that what I have set out below is fair and reasonable given Mrs H's circumstances when she invested.

My proposed compensation calculation requires Funding Circle to:

- *calculate how much Mrs H has received back from her initial investment into loan one - including any interest and funds that have been recovered and returned to her (A) - the actual value;*
- *then calculate how much Mrs H would've received had she received an *average rate of return for loans of similar risk across the platform from the date she invested in loan one until the date in 2017 Funding Circle changed its terms and conditions** (B) - the fair value.*

If B is greater than A, Funding Circle should pay Mrs H 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 Mrs H 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.*

*** As Mrs H original complaint makes it clear that she did not accept the terms Funding Circle introduced in September 2017, I think it's reasonable to assume she wouldn't have invested further on the platform after this date, so any loss should be crystallised from this point.*

Finally, I have considered Mrs H's request for in compensation to recognise the distress and inconvenience she has suffered as a result of the whole situation. It is apparent that Mrs H has spent time pursuing the matter and has faced uncertainty about the return of her investment. I'm conscious that any investment in a crowdfunding platform isn't guaranteed to be successful and there always a risk to capital. But I thinks she has spent time conducting research on the loans where Funding Circle has not provided her with clarity of information that it is reasonable for her to expect would be provided. This has meant she spent considerable time trying to obtain information. Based on this, I currently think it is reasonable for Mrs H to be awarded £150 compensation to recognise the inconvenience she has suffered."

Mrs H responded to the provisional decision with further comments. In summary she said:

She doesn't find Funding Circle's position that the security for the loan was only for the development building to be credible. She references entries on the land registry to support her opinion that the title deed was carved up and reducing the value of the security for loan one. She said a commercial unit within the development property was sold in Spring 2017 – but none of the proceeds of this sale were sent to lenders, so she believes this is another reduction in the security.

In respect of the proposed compensation, Mrs H agrees with the intention of deriving a fair value for the purpose of the proposed calculation. She is concerned about it being left to Funding Circle to decide what the loan basis is to generate the fair value. She suggests using an average return from A+/A rated property backed loans to calculate the fair value. But she also thinks loans one and four, that were subject to this complaint, should be

excluded – as it doesn't seem equitable to include these loans when there have been large losses. She believes this is fairer because it excludes the effect of Funding Circle's failings.

She provided an update from Funding Circle that was published in April 2017. This explained that it was withdrawing from property loans to focus on unsecured business loans. Within the article was information to say the net returns for investors in property loans to that date had been 7%. She suggests an alternative figure to calculate the fair value could be 7% as this was the average return for all property backed loans up to April 2017.

Funding Circle didn't respond or provide any new information or evidence for me to consider.

My findings

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

As Funding Circle has not made more comments or arguments for me to consider, I've got no reason to change the outcome I set out in my provisional decision.

I have noted Mrs H's comments about the security, which essentially agree with the findings in my provisional decision.

To confirm, for the reasons described in my provisional decision, I find that Funding Circle failed to provide Mrs H with clear, fair and misleading information when promoting loan one. But for these failings, I don't think Mrs H would have invested in loan one. I uphold this complaint.

Putting things right

As I've reached the finding that Mrs H would not have invested in this loan, I next need to decide what she would have done with the money she invested. I think it likely that she would have invested in further crowdfunding opportunities. I'm satisfied that she had an interest in using Funding Circle's platform as a way of seeking a return on her money. It's difficult to know exactly what other loans she would have invested in – as that would depend on what other loans were available. Having carefully considered all the available information and evidence, I think the fairest way to compensate Mrs H is to assume a rate of return that is equal to average return on loans of a similar risk profile on Funding Circle's platform. I say this because I'm satisfied that Mrs H would have continued to invest on the platform, but I take the view that she would have invested differently. It is not possible to say precisely what she would have done differently. But I am satisfied that what I have set out below is fair and reasonable given Mrs H's circumstances when she invested.

I've considered the further comments Mrs H has made about the proposed redress. I note she agrees with the intention of deriving a fair value but is concerned with how this will be established. In my provisional decision I said Funding Circle should use the average rate of return for loans of similar risk across the platform. I'd like to provide some further clarity on this point. Funding Circle rated loan one as a risk banding A+ - so the comparison should use the loans in this risk banding. Loan one should be excluded from calculating the fair value as the findings in my decision are that Mrs H wouldn't have invested in this loan. Mrs H believes loan four should be excluded. I understand that this loan has a different risk rating to loan one, assuming this is correct it wouldn't be included in the calculation.

Mrs H has mentioned that's she would also accept a fair value at an assumed rate of 7% as this was published by Funding Circle as the average return of property loans up to April 2017. While, I understand why Mrs H has suggested this as an alternative, I think the methodology of comparing loans in the same risk banding as loan one is a more accurate way of deciding what she is most likely to have invested in.

What should Funding Circle do?

To compensate Mrs H fairly, Funding Circle must:

- calculate how much Mrs H has received back from her initial investment into loan one - including any interest and funds that have been recovered and returned to her (A) - the actual value;
- then calculate how much Mrs H would've received had she received an *average rate of return for A+ rated loans (excluding loan one) across the platform from the date she invested in loan one until the date in 2017 Funding Circle changed its terms and conditions** (B) - the fair value.

If B is greater than A, Funding Circle should pay Mrs H 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 Mrs H 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.

** As Mrs H's original complaint makes it clear that she did not accept the terms Funding Circle introduced in September 2017, I think it's reasonable to assume she wouldn't have invested further on the platform after this date, so any loss should be crystallised from this point.

Finally, I have considered Mrs H's request for compensation to recognise the distress and inconvenience she has suffered as a result of the situation. It is apparent that Mrs H has spent time pursuing the matter and has faced uncertainty about the return of her investment. I'm conscious that any investment in a crowdfunding platform isn't guaranteed to be successful and there is always a risk to capital. But she has spent considerable time conducting research on her loans because Funding Circle didn't always provide her with clarity of information – which I think was reasonable for her to expect. Based on this, Funding Circle should pay Mrs H £150 compensation to recognise the inconvenience she has suffered.

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 Mrs H to accept or reject my decision before 30 July 2021.

Daniel Little
Ombudsman