



THE ULTIMATE GUIDE TO PEER-TO-PEER LENDING

Introduction

Why have we created this guide?



Peer-to-peer (P2P) lending isn't complicated, but if you're new to it, it can be difficult to know where to start. Anyone considering investing in **peer-to-peer lending** should have a good understanding of how it works and be aware of the risks as well as the benefits.

If this is the first time you've searched for peer-to-peer lending, or you feel you sort-of, kind-of know what it is, this guide should answer your questions so that you're able to invest and borrow with more confidence.

What is peer-to-peer lending?

Peer-to-peer lending platforms bring together people that want to invest money with people that want to borrow money.

For example, **you might have £1,000 to invest**, and **someone else might need £1,000 to buy a car**. It could be beneficial to both of you if you were to lend money to that person. Peer-to-peer platforms take care of checking that the borrower is creditworthy, transferring the money, collecting the repayments and channelling them back to you, the investor.

£2.85bn

lent in 2015

by P2P lending platforms

£5.5bn

Total amount lent

since 2005 by P2P lending platforms

Source: AltFi

Isn't that what banks and building societies are for?



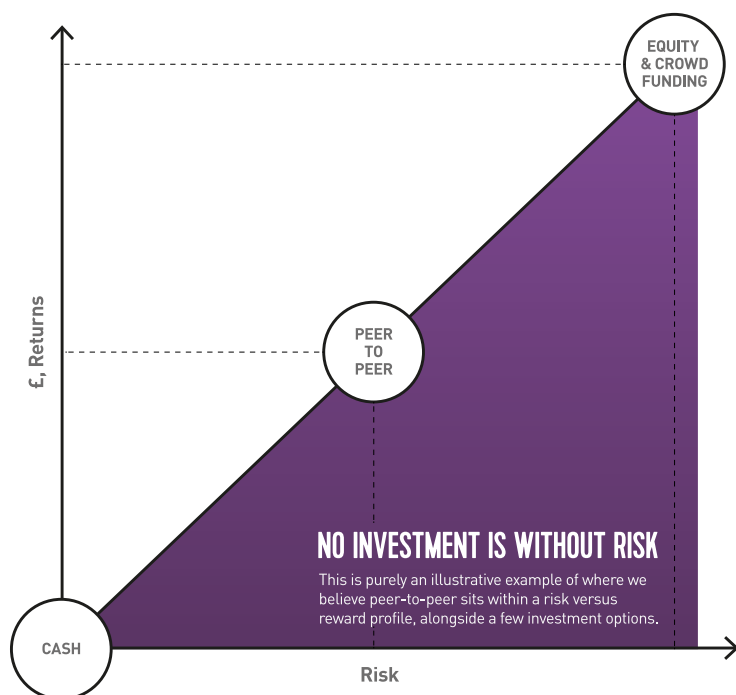
Banks and building societies do something similar (they invest the money you keep in your bank account, and might lend some of it to someone else to buy a car, for example).

Banks and building societies can be very complicated and expensive organisations to run: they often operate in multiple countries, maintain physical branch networks

and do lots of things – you might be able to buy insurance, take out a mortgage, exchange pounds to euros, send money to Brazil and apply for a credit card, all with just one bank.

Peer-to-peer lenders do one thing (allow people to invest and borrow money) and we believe we do it very well.

I've heard about crowdfunding – is this the same as P2P?



Peer-to-peer lending is very different from crowdfunding. People using crowdfunding platforms invest for either equity (meaning that they'll own a small part of the business, similar to buying shares) or for a reward (for example, if a singer is crowdfunding to record an album, he may give a copy to investors rather than offer a financial return).

The FCA considers equity-based crowdfunding in particular to be a high-risk investment activity, and warns that "it's very likely that you will lose all your money".

[> Read full article](#)

Sounds great. What's the catch?

When you personally lend money to someone, there's a risk that they won't pay the money back. However, if you deposit your money in a bank account, the Government's Financial Services Compensation Scheme (FSCS) guarantees that, whatever happens, you'll get your money back up to a limit, which currently stands at £75,000.

Peer-to-peer lending platforms are not covered by the Government guarantee scheme and therefore investors' money is at risk. P2P Platforms manage risk in other ways including provision funds, insurance schemes and

diversification. RateSetter has a Provision Fund (more on that later) which compensates investors in the event of a loss. It has a perfect track record of protecting individual investors since we launched in 2010, but the important thing to note is that no peer-to-peer platform can guarantee the safety of your money.

Peer-to-peer lending always involves risk – but with that risk comes the prospect of better returns compared to cash savings products.



Possible protections

PROVISION FUND

- Some platforms use a provision fund to protect investors
- This is a pot of money which repays investors if a borrower misses a payment
- It's not a guarantee, but provides a layer of protection for investors

DIVERSITY OF LENDING

- Splitting your lending up between lots of different borrowers makes investing safer
- Most platforms encourage investors to lend to multiple borrowers (in some cases, thousands)
- Some platforms also lend to multiple types of borrowers (e.g. individuals, businesses and property developers)

FCA

- Regulates the peer-to-peer lending industry
- Ensures that the financial industry is run with integrity
- Requires that peer-to-peer lenders provide consumers with appropriate products and services, and lend responsibly

How big is the peer-to-peer sector?

5.5bn

UK peer-to-peer lending platforms have lent more than £5.5bn since 2005.

January 2016

Are there any tax breaks for investing through peer-to-peer platforms?



Innovative Finance ISA

From April 2016 it will be possible to include peer-to-peer loans within an ISA – doing so means that all returns within the ISA will be tax-free.

Personal Savings Allowance

The personal savings allowance which was recently announced by the government also means that investors will be able to earn a certain amount of interest from peer-to-peer investments without paying tax – for higher rate taxpayers this amount is £500; for everyone else it's £1,000.

Is the peer-to-peer sector regulated? Who steps in if something goes wrong?

Yes – the **Financial Conduct Authority (FCA)**, which also regulates banks and independent financial advisers is responsible for regulating all peer-to-peer lending platforms.

If something goes wrong, you should first give the platform the chance to put things right – all platforms have a duty to do so. However, if you don't think that your complaint has been resolved properly, you can contact the Financial Ombudsman Service, which settles disputes if there's a serious disagreement.



Investing on peer-to-peer platforms

There are a number of factors potential investors should consider when looking at peer-to-peer platforms. Here we outline four key things to look for:

1 What happens if a borrower doesn't repay a loan?

All platforms suffer defaults when borrowers fail to make a payment. Most platforms have systems in place to reduce losses, ideally to 0%. There are two main ways of dealing with defaults across the P2P sector.

The first way is to encourage investors to spread risk, by lending to as many different borrowers as possible or doing this automatically. That way, ideally you've lent to so many different borrowers that a small number of defaults would only have a minor impact on your overall return. Of course, a high number of losses can still cause problems, and if you've failed to diversify properly, even a small number of defaults could leave you with substantial losses.

Alternatively a platform can build up a fund to compensate investors for any losses, called a [provision fund](#). Some peer-to-peer lenders have provision funds with perfect track records, although of course this is not a guarantee for the future and capital is at risk.



2 How robust is the credit checking process?

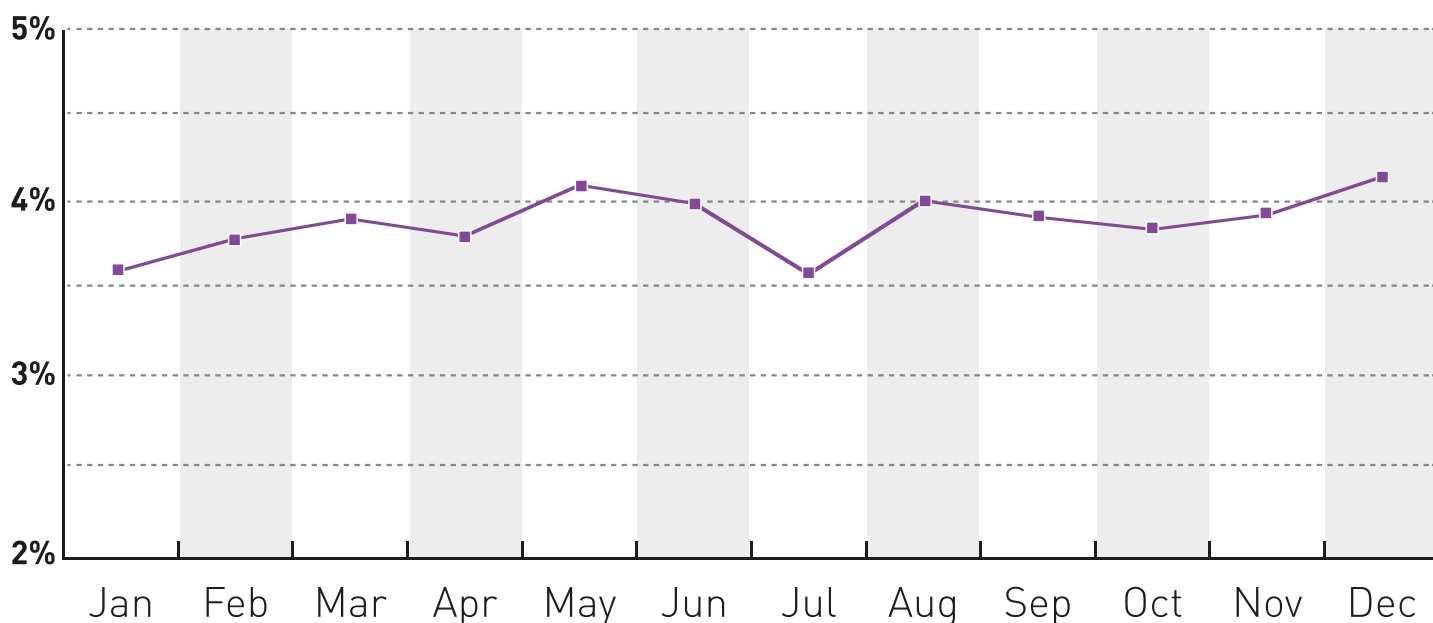
In order to ensure that it gets a clear picture of every potential borrower's credit history and ability to repay a loan, a platform should employ experienced and skilled credit underwriters that thoroughly assess applications from people and businesses seeking loans. In doing

this, it should use at least one of the major UK credit bureaux (such as Equifax, CallCredit and Experian). Good platforms will also publish their track record of defaults, and they should be happy to discuss their systems and processes with you.

3 What's the expected return?

In general, interest rates for investors on P2P platforms are set by the platform itself (in a similar way that banks set the interest rates on their saving accounts). On our platform RateSetter, investors can set their own rate, or choose to invest at the market rate. Average rates for our one year product in 2015 are shown below.

Different platforms have different fee structures, but you should ensure that the rate you're seeing advertised is the gross annualised return you will receive, and that it factors in all applicable fees.



— Average rates on RateSetter's one year product by month

4 Is the platform regulated by the FCA?



It's vital that peer-to-peer platforms are fully compliant with Financial Conduct Authority regulations. They should also be members of CIFAS, the UK's fraud watchdog - if not, the platform has no way of checking whether a potential borrower is fraudulent. Also ask whether the platform you're considering belongs to the P2P Finance Association, the industry's trade body, which sets minimum standards that member platforms must follow.

What next?

We hope you've found this guide to the industry useful. We've put it together to give an overview of peer-to-peer lending, and if it's something you're interested in, naturally we'd encourage you to visit our website at www.ratesetter.com, where you can find out more about our products and how to get started.

Glossary

Term: Another way of referring to the length of time that an investment or deposit is meant to last. A loan which lasts for five years has a term of five years.

ISA: Stands for Individual Savings Account. You don't pay tax on interest you earn in an ISA, and you can invest in cash accounts or stocks and shares within an ISA. From 6 April 2016, you will also be able to invest in [peer-to-peer loans in an ISA](#).

Annualised rate: a rate of return for a period which is less than one year, but that is computed as if the rate were for the full year. This allows for easier comparison between products with different terms.

If your question isn't answered here then we'd love to hear from you – email contactus@ratesetter.com and we will do our best to answer your question and, if appropriate, add it to this document.
