Peer-to-peer lending

Peer-to-peer lending promised 6%, but I've been left red-faced and in the red

Miles Brignall

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When James Patterson invested £1,000 in the peer-to-peer (P2P) lender Funding Circle back in 2015, his hope was that his money would grow a bit faster than the pitiful rates of interest offered by his bank. At the time, the relatively new lender was promising returns of 5-6% a year - 10 times more than his bank.

However, almost a year and a half on, his investment is now worth just £988 - a loss of £12. It's because one of the firms that 10% of his money was lent to defaulted, leaving his account £128 in the red - a sum that his other investments at the platform have struggled to make up.

In the week that Funding Circle, and several rival big-name P2P lenders gained full authorisation from the Financial Conduct Authority - which paves the way for them to start offering tax-free "innovative finance" Isas (*see below*) - his case is a reminder that P2P lending is not without its risks.

It has delivered some impressive returns to savers in recent years but, Patterson says, after his experience, he will not be investing anymore.

The therapist from Bedford says P2P lenders, which take investors' money and lend it to others looking for a loan, came to his attention in an article on the MoneySavingExpert website.

"I'd seen a lot on P2P lending on the site and decided to dip my toe in the water with £1,000.

"The interest rates offered by conventional savings at my bank were so woeful - the promise of 5-6% looked much more like it."

He says he logged on to the Funding Circle website and followed the instructions but, unbeknown to him at the time, he had not chosen to spread his investment as much as he could. This left him vulnerable to the loss he subsequently suffered.

> **Maybe I was a bit too quick to put my money in and I should have spent more time looking into it all in detail**

His latest Funding Circle tax statement shows he earned £129 interest, which was reduced to £115 after Funding Circle's service fee of £13.77 was applied. His bad debt of £128 left him, he admits, "red-faced and in the red".

"Maybe I was a bit too quick to put my money in and I should have spent more time looking into it all in detail but I just followed the instructions," he says.

James Meekings, co-founder and managing director of Funding Circle, says Patterson will be back in the black in the next couple of months as the firm expects to recover some of his losses which, in turn, will be passed on to him.

"Since Funding Circle launched, investors have earned an average of 6.5% a year and £116m of net interest," Meekings says. "We encourage investors to lend small amounts to lots of businesses to ensure any bad debt does not have a significant impact on overall return.

"Every investor who has lent to 100 businesses evenly has earned a positive return with 91% earning 5% or more."

The company says Patterson had chosen to loan 10% of his investment to a single borrower, but he has since turned on "autobid". This automatically spreads a saver's investments to the point where no more than approximately 2% is lent to any one business.

It tells Money that in 2015 many Funding Circle users wanted to choose the companies they invested in. Now it more actively promotes its autobid facility.

** James Patterson is not his real name.*

Is a peer-to-peer savings scheme right for you?

▲ Although the introduction of P2P Isas has given the sector an aura of respectability, the reality is that savers can lose every penny of their money. Photograph: Alamy

Savers are being lured by returns sometimes as high as 10% a year, *writes Patrick Collinson*. City investors are pouring funds into peer-to-peer (P2P) startups in the belief that they are the next big thing in finance. The government has allowed P2P firms to offer Isas, and in recent weeks the Financial Conduct Authority, after many months of investigating the sector, has given its blessing to many firms in the form of formal FCA authorisation.

This means the firms can now legally offer their products within an Isa, so the returns are tax-free. However, it has taken many more months than expected for some P2P firms to obtain FCA authorisation, and many are still waiting.

Zopa, the granddaddy of the P2P sector, obtained its full authorisation at the beginning of May and was followed by Funding Circle last week. But RateSetter, the other of the big three in the sector, is still to obtain full authorisation. Some of the smaller players obtained authorisation months ago. Folk2Folk, which specialises in loans secured against property, was authorised in December.

RateSetter expects to obtain authorisation soon and points to the £13m it has obtained in new equity funding from big investors such as Neil Woodford. It said it was using the money to "scale up the business ahead of the anticipated launch of its innovative finance Isa".

The top advertised rates of return on P2P lending are about 10-12% a year, but anyone considering such an investment should understand it involves a considerable degree of risk.

Although the introduction of P2P Isas has given the sector an aura of respectability, the reality is that, unlike a deposit account, savers in P2P schemes can lose every penny of their money. There is no Financial Services Compensation Scheme to come to the rescue should a firm go bust.

There are fears of overheating in the market, with ever more entrants pushing down the pricing and quality of credit. In other words, the borrowers who take your money don't pay as much interest as before and are perhaps more at risk of failing.

In December, Zopa shocked the market by telling savers it would not accept any more money. It said it did not want to compromise the high standards of lending that it maintained - and six months later it is still operating a waiting list for investors.

Some have taken Zopa's withdrawal as a warning that credit standards in the rest of the sector are slipping. Yet, Zopa announced this week that it had obtained new venture capital funding and expects to lend around £1bn this year. It is planning to open again to new investors towards the end of summer.

A selection of P2P deals:

RateSetter

One of the big three in P2P lending, RateSetter has so far lent out nearly £2bn. New investors are offered a "rolling" rate currently between 2.7-3%, which allows relatively easy access if you want to cash out. It also offers 2% for its one-year market fund and 4.8% for money that is lent on five-year terms.

RateSetter has built up a provision fund of £14m so far to pay out in the event of defaults, while adding that this should not be seen as a guarantee. RateSetter has not yet received full FCA authorisation but says its Isa is "coming soon".

Zopa

The first P2P lender to launch in the UK obtained FCA authorisation in May and will launch its Isa on 15 June. It will have a target interest rate of 3.9% for its lower-risk fund, or 6.1% for its higher-risk fund. However, Zopa is open only to existing investors. It operates a waiting list for others keen to invest.

Funding Circle

The firm focuses on lending to small businesses rather than individuals, offering generally higher returns but with arguably more risk. It says its current estimated return is 7.2% and it encourages investors to use its autobid facility to ensure their money is spread across loans to at least 100 companies. Funding Circle overtook Zopa recently to become the biggest P2P lender, with £2.9bn lent so far.

Folk2Folk

Full FCA authorisation has been obtained and an Isa is expected to be launched with a target interest rate of 5.5-6.5%, but with a minimum investment of £20,000. The money is lent for business purposes with property or land secured against the loan at a maximum loan-to-value of 60%.

Kuflink

This relatively new provider focuses on bridging loans and has received FCA authorisation. Kuflink has five deals listed on its site for periods of six and nine months, paying between 6% and 7%.

Landbay

It invests in buy-to-let mortgages with terms of up to 10 years. The P2P firm has obtained FCA authorisation and has an Isa available. It is offering a tracker rate with a targeted return of 3.4% or a fixed rate offering 3.75%.

Unregulated spiv investments... what could possibly go wrong?

Mute Report

PeMu666 ↪ Aspirationalsocialis 3 Jun 2017 7:48 5

Interestingly a lot of the companies mentioned here have asked for more regulation: https://www.ft.com/content/b3c2c6ac-8bca-11e6-8aa5-f79f5696c731

Mute Report

simpleeconomics ↪ Aspirationalsocialis 3 Jun 2017 8:32 14

Nothing wrong with these companies bigger issue is people not taking responsibility for there own actions.

Mute Report

oommph ↪ Aspirationalsocialis 3 Jun 2017 8:44 2

It is interesting that much of the scepticism of a few years ago has turned out to be correct.

If something sounds too good to be true.......

> Interestingly a lot of the companies mentioned here have asked for more regulation

Is that not usually how it works? Those heavily promoting the virtues of capitalism and "free markets" at the start tend to ask for state protection soon after.

Mute Report

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ASaltyDog 3 Jun 2017 7:42 24

P2P investments should be seen as long term. If you are going to make unsecured loans you must expect to lose money from time to time. It's not the same as putting your money in the bank and that's the only reason why it pays better. If you want a safe investment then put your money in a long term savings bond earning a lot less. You won't get 5% returns without risk for the forseable future.

Mute Report

praha7 ↪ ASaltyDog 3 Jun 2017 11:47 6

Precisely.
I would only add to that that you should only invest money you can afford to lose.

Mute Report

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