

Guide for peer-to-peer lending services on publishing default rate information

This document contains information to help peer-to-peer licensees understand and meet the minimum licensing standard to publish default rate information. It sets out:

- what 'default' means
- when licensees must comply with the standard
- guidelines on how to publish fair, clear and transparent information.

About this guide:

This information sheet is for:

Licensed peer-to-peer lending services

It explains:

The minimum standard to publish default rate information



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Introduction

Peer-to-peer lending service licensees must meet a number of minimum standards to comply with their licence obligations. These standards are set out in the [licensing application guide for peer-to-peer lending](#). One of the minimum standards relates to providing investors (lenders) with transparent information and includes the following:

“You publish information about the rate of default by borrowers using your facility – and this is published in a fair, clear and transparent manner.”

This document provides additional information supporting the licensing guide, to help applicants and licensees understand and meet this standard. It sets out:

- what ‘default’ means
- when licensees must comply with the standard
- guidelines on how to ensure the information published is fair, clear and transparent.

Meaning of default

The minimum standard aims to give investors a view of the potential risk of losing money with a peer-to-peer service, should borrowers fail to repay some or all of their loans. The primary meaning of ‘default’ within the licensing standard is therefore equivalent to a ‘write-off’, ‘charge off’, ‘bad debt’, or any other terminology your service might use to refer to that situation.

A ‘default’, as referred to in the minimum standard, means a loan that:

- is no longer reasonably expected to be paid; and/or
- is no longer reported to the lender(s) as due to them, whether or not funds may still be recovered from the borrower by other means such as debt collection procedures; and/or
- has been sold pursuant to a debt collection procedure.

This definition is the same as the one used when we ask for information about ‘loans written off’ in the peer-to-peer regulatory returns. ‘Default’ has this meaning throughout this document.

To comply with the minimum standard, you must publish information about ‘defaults’ within this meaning. Your service might also use the term ‘default’ for other circumstances, for instance when loan repayments are in arrears

but the loan is still reported as due to investors. You can choose to publish information about these other 'default' situations as well.

When compliance is required

Publishing default information

You must publish information about defaults:

- no later than **two years** after the licence is issued if your business is a **new start-up** when you get your licence
- no later than **one year** after the licence is issued if your business is **pre-existing** and has investors and/or borrowers when you get your licence.

We will confirm which requirement applies to your business during the licence application process. An applicant or licensee can request a variation to these timeframes if features of the particular service mean publishing default rates within these timeframes may not be appropriate. If you think this might be the case for your business, please talk to us as early as possible.

Even if your service's default rate is zero after the requisite period, you will need to begin publishing the required information. This would include relevant context as described in this document, for example how and when your service determines there has been a default.

Rationale

The minimum standard aims to give investors a view of the potential risk of losing money invested in peer-to-peer loans. For default information to be a useful measure of this risk, a peer-to-peer service should ideally be sufficiently established and have handled enough loans that a 'normal' level of default has begun to appear. Default information in the early stages of operation may be misleading rather than helpful to investors. For this reason, we do not require peer-to-peer services to comply with this minimum standard as soon as they are licensed.

Before we determined what would be an appropriate time for licensees to comply with the minimum standard, we looked at the value and volume of new loans made through peer-to-peer services in the first two to three years after licensing. We also looked at average minimum and maximum loan terms.

We found that service providers starting as new businesses have generally established a sufficient level of activity after two years that their information about defaults would be helpful to potential investors. We believe two years would also allow a sufficient proportion of loans to progress to a point where defaults would likely materialise, if they were going to happen.

In our view, licensees with an existing client base and loan book at the time of licensing will likely have reached those milestones within one year.

We acknowledge that default information is likely to become more meaningful as a measure of a service's risk over several years, when a variety of loans of different sizes and terms have been through full cycles. However, earlier data can still provide investors with useful information about the potential risk of investing with the peer-to-peer service. The minimum standard will be ineffective if licensees are not required to comply within a reasonable timeframe after licensing.

Can I publish default rates sooner?

You can choose to publish default rates earlier than required. However, remember the [fair dealing provisions](#) of the Financial Markets Conduct Act apply, so make sure the information you publish is not misleading.

Publishing default information at an early stage of business could be misleading if the full context of that rate is not clear. For example, the default rate may be zero because few loans have been made and the sample size for the statistic is therefore too small to give a fair view of default rates. Our guidelines below help you publish information in a 'fair, clear and transparent manner'.

Publishing fair, clear and transparent information

The requirement for default information to be fair, clear and transparent aligns with the fair dealing provisions of the Financial Markets Conduct Act. You should read our [Guidance Note](#) on how the fair dealing provisions apply to peer-to-peer lending services.

There is currently no prescribed format or content for the reporting. Each licensee should determine what information about defaults is most appropriate and relevant to investors in its service. However, the following is some information we would expect to see to ensure the 'fair, clear and transparent' standard and the fair dealing provisions are met.

Explain your service's definition of 'default'

Different peer-to-peer licensees convert loans to defaults after different lengths of time, which affects when they are included in default rate calculations. Licensees also use varying terminology.

We expect licensees to clearly disclose the definition and parameters that apply to a default on their particular service.

For example: *'A loan is written off* when a repayment is overdue by 60* days and there is no longer a reasonable expectation of payment. When a loan is written off it will no longer appear on investors' accounts.'*

** These terms have been chosen for example purposes. The terminology and timeframe may be different for your service.*

Similarly, if you choose to publish other information (for example, about loans in arrears) you should clearly explain the information you are showing, any terminology used, and the differences between different sets of information.

All explanations should be shown alongside the published default information. Potential investors should not be directed to look for it elsewhere, such as in your disclosure statement.

Show default information for each risk grade

Individual peer-to-peer services can offer a variety of loans. Variations include risk grades, length, purpose and size of loans allowed, and whether security is required. These factors influence whether defaults occur.

In particular, the rate of default is likely to vary between risk grades, increasing with the level of risk. Publishing an average default rate across all loans would likely mask the rate of default in individual categories, and could therefore be misleading.

You should show a separate rate of default for each loan risk category available through your service.

Show 'gross' default information

Some peer-to-peer services offer secured loans or other forms of capital repayment protection, to reduce investor loss if a borrower fails to repay their loan. Services also usually continue to try to recover money after they convert loans to defaults. This means funds might still be returned to investors after a default is declared.

Information should be published about the gross level of defaults (i.e. before any debt collection or security protection is implemented).

This will give investors a fairer view of the total potential risk of losing their capital, because debt recovery processes do not guarantee a return to investors. Also, when funds are recovered through debt collection or asset sales, they can be reduced by fees or because security assets do not achieve full value.

You can publish net figures as well, to show investors the level of recovery that can be achieved. Make sure the two sets of information are clearly differentiated and given equal prominence – don't publish a 'headline' net rate with a less obvious gross rate. You should also show and explain the calculation of any net rates; for example, is the value of funds recovered before or after debt collection fees have been deducted?

Below are some additional guidelines to consider when publishing information about defaults.

Put the information in context

Showing a rate of default in isolation is unlikely to be fair, clear and transparent. Investors should be able to understand the full context of the information shown. You should explain how a default rate is calculated and the parameters of the numbers used in the calculation. For example, is it cumulative defaults over time, or defaults from a particular period? If you show a rate for a period, be clear what that period is and what figures from the period have

been used. Showing dollar values, or the number of loans made, might give further useful context to a percentage rate.

It is also more likely to be transparent to show rates over a time continuum rather than at a single point in time. Our [fair dealing guidance](#) advises on avoiding ‘cherry-picking’ performance information, and the same principle applies to default rates.

Consider different ways to show the information

As well as showing defaults by risk grade, we encourage you to consider whether it is appropriate to show default rates for other cross-sections of loans for comparison, especially if your service has a wide range of loan options. For example, you might publish default rates for secured loans compared to unsecured loans, or personal loans compared to business loans. This information could help investors decide what loans to invest in.

It might also be appropriate to report default rates according to the age of loans, particularly if your service is in a growth phase and the number of new loans is increasing exponentially. Defaults are more likely to eventuate as loans age, so the default rate for newer loans will generally be lower than for more mature loans. An average rate of default, over a period that combines a high proportion of new loans with older loans, could be misleading.

If the nature or terms of your service has changed at any time, for example if you have added new loan types, you will likely need to show separate default rates for before and after the changes.

The more loan options your service provides, and the longer your service has been licensed, the more likely it is that it will be appropriate for you to show default information in a number of different ways.

Make the information accessible

Information about defaults should be easy for investors to find. Give it an obvious heading and show it as a distinct item in a menu of investor information on your website. Provide a link from information about investment risks, and consider putting it on a stand-alone page of the website. If your service doesn't have a website, you still need to compile information about default rates that conforms to the requirements and recommendations in this information sheet, and provide it if asked.

Your investor documentation should also tell investors that default information is available, and where to find it.

Further information

If you have any queries about this information sheet or your obligations, please visit www.fma.govt.nz or contact the FMA and ask for the Capital Markets Conduct team.

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