P2Ps in India – Tightrope walking

- A report on P2Ps in India | 2017

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FOREWORD

As technology continues to change the way we book flights, book a taxi, or search for a hotel room, fintech continues to make massive transformation in the way flow of money and settlements of transactions happen. One of the ways fintech continues to make significant impact on the world of finance is to enable fintech-based lending. Known by various names as fintech credit, marketplace lending, crowdfunding of loans, P2P lending, etc., there is no doubt that these forms of lending transactions are the most remarkable development of the decade.

It may be sensible to distinguish the amplitude of each of the terms – the term fintech credit is quite broad, including in its ambit all forms of credit originated making use of fintech – including online lending. Marketplace lending include lending where lenders and borrowers are connected making use of online platforms, but on the supply side, there are wholesale lenders as well as "peers". Strictly speaking, the term P2P lending should include only such lending where there are peers on both the sides – that is, lending by persons who are not professional lenders, connected with borrowers mostly including individuals and small businesses. However, these terms are mostly intermixed. In this report, we have used the term P2P lending as implying marketplace lending.

The growth of marketplace lending over the recent years has been phenomenal. While in more mature markets such as the USA, there have been periods of slow growth or negative growth in personal lending, at the same time, the growth in SME-focused lending or student loans has made good for the reduced volumes. China has been the driver of global P2P lending volumes: the Chinese market has been suffering ever since regulators have imposed norms of ticket size as well a requirement that the platform will not support loan losses, or will not undertake risk absorption. Elsewhere in the world, volumes have continued to surge, as lots of traditional lenders have found this a new way to expand their loan books.

As the marketplace lending industry gains its size, it obviously became the target for regulatory attention. In fact, the latter might have been far higher than the growth itself. There have been arguments that the growth of P2P lending will weaken financial stability, since regulators will find it difficult to monitor a largely dispersed base of lenders or lending platforms. There are issues of frauds, causing wide-spread losses. Additionally, the platforms, with little skin in the game but with impressive data of high returns and low defaults in the past, may attract lenders thereby reducing underwriting standards, promoting lax lending, and so on. Prof Jan Kregel of the Levy Economics Institute warned regulators thus: "The new payments systems have the ability to evade or distort regulation on financial institutions, and p2p lending systems replace due diligence of banks with algorithms. The regulation of this system is thus critical. P2p lending is the modern day equivalent of Securities Affiliates, which were at the centre of fraud in the run-up to the Great Depression. These systems eliminate normal due diligence, and they pose a huge threat to stability in the system."[1] Thus, unsurprisingly, regulation of P2P lending has been the regulatory theme. Chinese regulators had come up with multi-agency regulations, imposing several regulatory norms. The USA continues with its approach dating back to 2008 holding that the tradable loan notes issued by P2P platforms are securities, and thus, come under the regulations of the SEC, whereas, if the platform is simply originating loans for the banks, the platform acts as a conduit to originate for the respective banks. Several of the US consumer lending laws also apply to P2P lending platforms. UK also regulates P2P lending through its Financial Conduct Authority.

In India, the RBI has notified P2P platforms to be NBFCs, using its powers conferred by sec. 45I (f) of the RBI Act. The notification paves the way for the RBI to regulate P2P platforms, for which a concept paper has been on public domain for quite some time now.

In India, the P2P business seems to be riding piggyback on the growth of consumer lending, which is currently seeming interesting for both banks, non-banking financial companies, as also informal lenders. The rates of return on P2P lending are substantially higher than those offered by traditional investment opportunities. To the extent this is the reason for attracting capital on the platforms, the same may be short-lived. Eventually, P2P lending has to thrive on building direct connectivity between the end-provider of money and the end-user of money - that is, the economics of disintermediation.

In this Report, we have tried to capture the development of the P2P lending business in India and the world. We have done primary research talking to several P2P lenders in business in India, and therefore, the Report is not merely a collation of work already done, but extends the understanding of the business in India with work of primary significance. We hope readers will find this work useful.

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[1]http://fessud.eu/financial-stability-risk-peer-peer-lending-new-payment-systems/

ABSTRACT

P2P lending is in a nascent stage in India. With the country boasting a wide smartphone user-base of around 150 million in 2016 along with an increased focus on financial inclusion, P2P lending has brought about the possibility of a major disruption in the way people avail credit, and the role of banks and financial institutions in this.

With the RBI coming out with the P2P Master Directions in October 2017, the industry now has formal recognition and no longer needs to operate in a regulatory grey area. There is now a definite set of guidelines and regulations that govern this industry. This report discusses these guidelines at length.

The report also discusses various models of P2P lending and draws on and discusses good and bad experiences worldwide, including from the USA, UK and China. It then goes on to compare the regulatory regime in India with that in these countries.

We also carried out a market survey among Indian P2P players concerning their business practices. The results are contained herein. P2Ps also offer an array of ancillary services such as credit assessment, profile verification and loan monitoring to name a few. We discuss these from a regulatory angle. Lastly, worldwide, P2P platforms have sought to counter investor hostility by maintaining a skin-in-the-game. These mechanisms are also discussed.

While so far P2Ps are complementary rather than competitive in nature to banks, it would be in the interest of both to join hands instead of competing with each other which would allow them to offer services to various classes of borrowers in conjunction rather than fight to win market share.

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