P2P Report | India & Global 2019-20

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ABBREVIATIONS

AFS	:	Australian Financial Services
ASIC	:	Australian Securities and Investment Commission
CAGR	:	Compound Annual Growth Rate
CBRC	:	China Banking Regulations Commission
CFPB	:	Consumer Financial Protection Bureau
CSA	:	Canadian Securities Administrator
EDGAR	:	Electronic Data Gathering, Analysis and Retrieval system
EMI	:	Electronic Monthly Instalment
FCA	:	Financial Conduct Authority
FD	:	Fixed Deposit
FICO	:	Fair, Issac and Company
FSDC	:	Financial Stability and Development Council
FTC	:	Federal Trade Commission
GBP	:	Great Britain Pound
IFISA	:	Innovative Finance Individual Savings Account
KYC	:	Know Your Customer
MF	:	Mutual Fund
MIS	:	Managed Investment Scheme
MSME	:	Micro, Small and Medium-sized Enterprises
NBFC	:	Non-Banking Financial Company
OSC	:	Ontario Securities Commission
P2PFA	:	P2P Financial Authority
P2P	:	Peer-to-peer
Q-o-Q	:	Quarter-on-Quarter
RBI	:	Reserve Bank of India
RMB	:	Renminbi
RoR	:	Rate Of Return
SEBI	:	Securities and Exchange Boards of India
SEC	:	Securities and Exchange Commission
SME	:	Small and Medium-sized Enterprises

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.

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-

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

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.

--**Vinod Kothari**

ABSTRACT

P2P lending is in a nascent stage in India. With the country boasting a wide mobile phone user base of around 1.190 billion in 2019 (up 2.8% year-on-year)[2] 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[3], the industry has a formally recognized legal framework, 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.

[2] As on Jan 2019 (https://datareportal.com/reports/digital-2019-india)

[3] Reviewed by RBI *vide* notification no. DOR.NBFC(PD) CC. No. 106/ 03.10.124/2019-120, dated 23.12.2019.

INTRODUCTION

BRIEF HISTORY

Peer-to-peer lending or P2P lending was launched by a U.K based firm called Zopa in 2005, followed by Prosper in 2006 in the U.S. Both the entities followed by several others boast of connecting millions of lenders and borrowers through the platform and of successful lending records over the years.

The idea widespread to Asian countries as well over the years and was the idea was often cited as an alternate or complementary role of banking. The concept of P2Ps has been extended to several kinds of business model, but doing lending using the proponents of P2P is what is causing a real disruption in the financial space.

This brings us to the most pertinent question as to what is P2P or P2P lending.

WHAT IS P2P AND HOW DOES P2P LENDING WORK?

More commonly referred to as “loan-based crowdfunding”, Peer-to-Peer lending is:

1. Interaction between two parties without the need for an intermediary who virtually meet and interact on a common network;
2. For loans/ financial assistance of unsecured nature.
3. P2P from a financial perspective, is facilitation of lending money to unrelated individuals, or "peers” without going through banks or other traditional financial institutions;
4. Lending takes place online on peer-to-peer lending platforms;
5. Operationally less cumbersome;
6. Easy registration and less cumbersome evaluation and documentation process along with faster loan processing time.

The following figure represents the transaction flow in a typical P2P transaction:

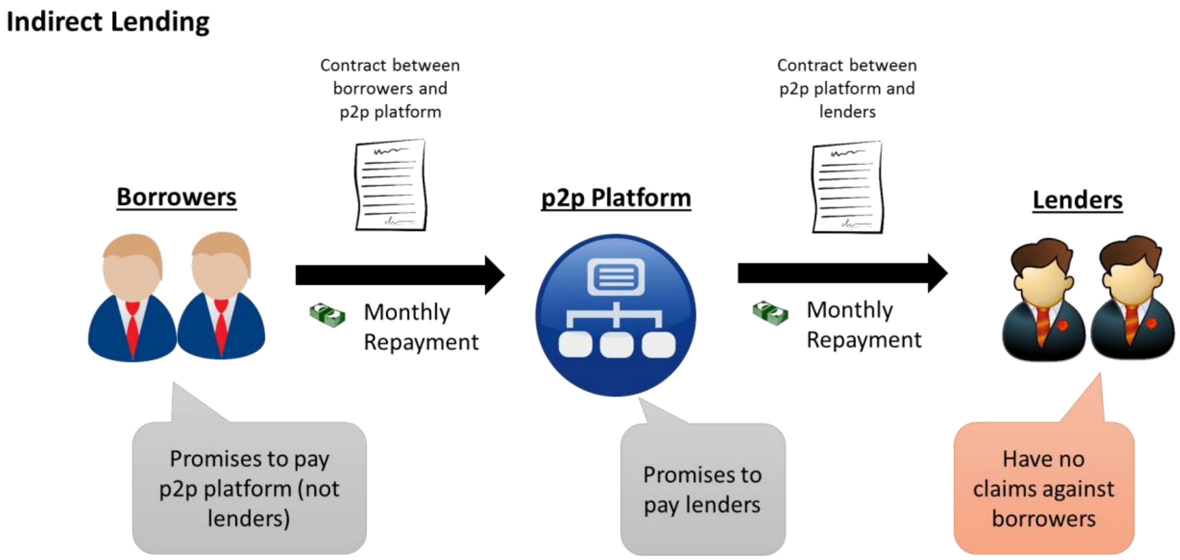

FIGURE 1: P2P LENDING PROCESS

The prospective borrower registers on the platform by submitting his/her credentials and makes an application for a loan. The platform would process the data, do a prelim credit evaluation and generate a report summary for the investor's perusal and the investor relying on the platform's credit evaluation report or with additional assessment on the borrower make the decision of lending.

The borrower pays a loan origination fee to the platform and the lender pays a fee for loan sourcing and processing to the platform, depending upon the terms of the platform. The interest rates are in some cases decided by the platform or could be decided mutually by the parties. Importantly, the routing of the money and well as individual loan contracts is directly transacted between the borrower and the lender, and the same is only monitored through the platform.

P2PS GROWING EDGE OVER BANKS?

As per the Global Findex Database 2017, issued by the World Bank[4], globally, about 1.7 billion adults remain unbanked—without an account at a financial institution or through a mobile money provider. Of such unbanked population, nearly half live in just seven developing economies *inter-alia* India. Tapping this void, the P2P Lending industry saw it as an opportunity to satisfy the high demand of borrowers, through matching them to yield-hungry investors.

4 https://globalfindex.worldbank.org/sites/globalfindex/files/2018-04/2017%20Findex%20full%20report_0.pdf

P2Ps have caused a disruption in the financial intermediation space. It has established that borrowing can go beyond traditional and conventional means, beyond banks and financial institutions and so lending could not be restricted to these financial institutions. The direct access of the haves and the have-nots is what makes the proposition so lucrative and is thus growing in demand on both sides. Just as was the case for unconventional businesses, where banks and financial institutions could not offer funds and it led to angel investors and venture funds coming to aid, something similar happened in the P2P space as well, as they operate in a parallel realm of financial facilitation.

One theory about P2Ps is that they will disrupt the existing organisational and institutional structure of banking[5]. The edge that P2Ps enjoy over banks is evident, with low administrative costs, P2Ps can operate in a low margin space, work with customers who are turned down by banks and use technology for rapid customer service. However, the model also suffers from some disadvantages which arise out of the fact that the invention is fairly new for apprehensions on genuineness of business, sustenance of the business model to invest money in, legality of the business, transparency in business transactions and acceptability to technology. These disadvantages seem to be only relevant till P2Ps have some seasoning and should get eased out with time. There are examples of disruptions quoted in The Business Models and Economics of Peer-to-Peer Lending which include recorded music distribution, telephony or in air travel reservations, Airbnb or BitTorrent (in consumer to consumer segment) etc. Currently P2Ps are seen as playing a complementary role to banks and financial institutions.

Crowdfunding is also a kind of P2P model, where several individuals invest for a common cause. In India, this is mostly used for creating a social impact (Ketto.org being an example, in this case).

On the business side, from a financial institutions' perspective, we understand that there is lack of outreach or unwillingness to cater to the financially excluded, as conventional means of financial facilitation do not recognise them. This limitation does not make them unsuitable candidates for lending. P2Ps not only confirm this theory but also are built on it.

On the other side, those with funds available for investment and looking for alternative means of investing also find the proposition much worthy of consideration, as the segment offers higher returns. While there is no authentic data available on the returns earned, business models adopted by

[5] The Business Models and Economics of Peer-to-Peer Lending by Alistair Milne, see link here https://www.ceps.eu/system/files/ECRI%20RR17%20P2P%20Lending.pdf

P2Ps in India, but in a dialogue with ET, Faircent reported that P2P lenders would earn a gross return of 18-26%[6].

An interesting comparative has been made for investors on why P2Ps are worthy of consideration as an investment option[7]:

Benchmarking						
Investment	**FD**	**Gold**	**MF**	**Real Estate**	**P2P**	**Rental Income**
RoR	6%	-12.50%	16%	5%	18%	7%
Taxable	Yes	Yes	Yes	Yes	Yes	Yes
Tax	30%	30%	0%	20%	30%	30%
Net RoR	4.20%	-8.75%	16.00%	4.00%	12.60%	4.90%
Downside	0%	10%	10%	0%	15%	0%
Invested	Rs. 1,00,000.00	Rs. 1,00,000.00	Rs. 1,00,000.00	Rs. 1,00,000.00	Rs. 1,00,000.00	Rs. 1,00,000.00
Risk Adj. Return	4.20%	-7.88%	14.40%	4.00%	10.71%	4.90%
Notes	YTD-returns	YTD-returns	YTD-returns (my avg. MF returns)	Annualised 5 year-to-date Return	Annualised 2 year return	Annualised 2 year return

Source: See footnote

One of the risks of lending on P2Ps is that they have a higher probability of to lower the returns in comparison to the mutual funds. In a later segment, we have analysed some of the aspects of P2P lending which also bring out these facets. A counter to this is that the risk is spread among several investors, if the P2P allows for several lenders to lend against a single loan. This in turn leads to spreading out of risks as against a bank offering loan to a similar customer.

The NASSCOM- KMPG report has forecasted the fintech market to cross $2.4 billion industry by 2020[8] and suggests that the P2Ps lending industry will grow into a $4-$5 billion industry by 2023. India currently has roughly 50 P2Ps, of

[6] http://economictimes.indiatimes.com/small-biz/money/over-90-lenders-in-p2p-lending-earn-gross-returns-of-18-26-per-annum-faircent-report/articleshow/58789339.cms

[7] https://p2plendingsite.wordpress.com/2017/06/30/12-benchmarking-p2p-alternative-vs-mainstream-returns/

[8] https://inc42.com/buzz/p2p-lending-fintech-loans/

which currently there are only 20 P2P platforms registered with RBI as per the data released by RBI as on October 31, 2019[9]

Although this industry is still in the nascent stage, the fast growth witnessed by this sector has caught the attention of the major players and even RBI, closer home.

BENEFITS OF P2P LENDING

P2P lending has, over few years, bought about turnaround changes in the economy as a whole and the way the masses look at their financial needs. It has aided the financial market in the following manner:

- Financial inclusion- The platforms enhance the availability of various alternative funding and investment options. Greater diversity in the sources of credit can also lower the risks that the economy faces when a few banks dominate credit provision
- Lower cost of credit- With availability of numerous options for funding, the demand and supply factors get operational. Thus, while demand being the same and the variety of sources widening, the cost is bound to lower down.
- Diversification of sources of credit in the economy.
- Cushion against idiosyncratic risks of banking system- “In other words, platforms might be a “spare tyre” for lending in the economy, much in the way some forms of market-based finance are for certain lending segments. While it is plausible that the funding environment could be unfavourable for FinTech credit platforms if there were concerns over the regulated banking system, in this case FinTech credit platforms might still provide another avenue through which credit could flow to other parts of the economy if bank lending were impaired”
- Resilience of lending in the economy to pure liquidity shocks.

Further, certain benefits exclusive to the lenders and borrowers are depitcted in the following table:

Benefits to borrowers	Benefits to lenders
Spreading Risk: A single P2P loan may be funded by a number of lenders, leading to distribution of risk among the borrowers.	**Easy Application:** Application can be made on-line by putting in a few pieces of personal information.
Higher Earnings: The lender uses his/her own discretion to finance a loan request, so he/she decides on the interest component of the loan.	**Speed of Funding:** Loans can be raised in matter of weeks, whereas the banks and other institutions takes over a months’ time to sanction a loan.

[9] https://www.rbi.org.in/Scripts/BS_NBFCList.aspx

Choice of borrowers: Lenders have the full knowledge of the parties to which his/her fund goes, unlike banks where the bank lend out the funds and the individual depositors have no knowledge where there funds are invested by the bank.	**Funding for all kinds of loans:** P2P loans can be raised for any amount, even amount **which** are small/ large enough for banks to reject them**.**

TYPES OF P2P MODELS

CLIENT-SEGREGATED ACCOUNT MODEL

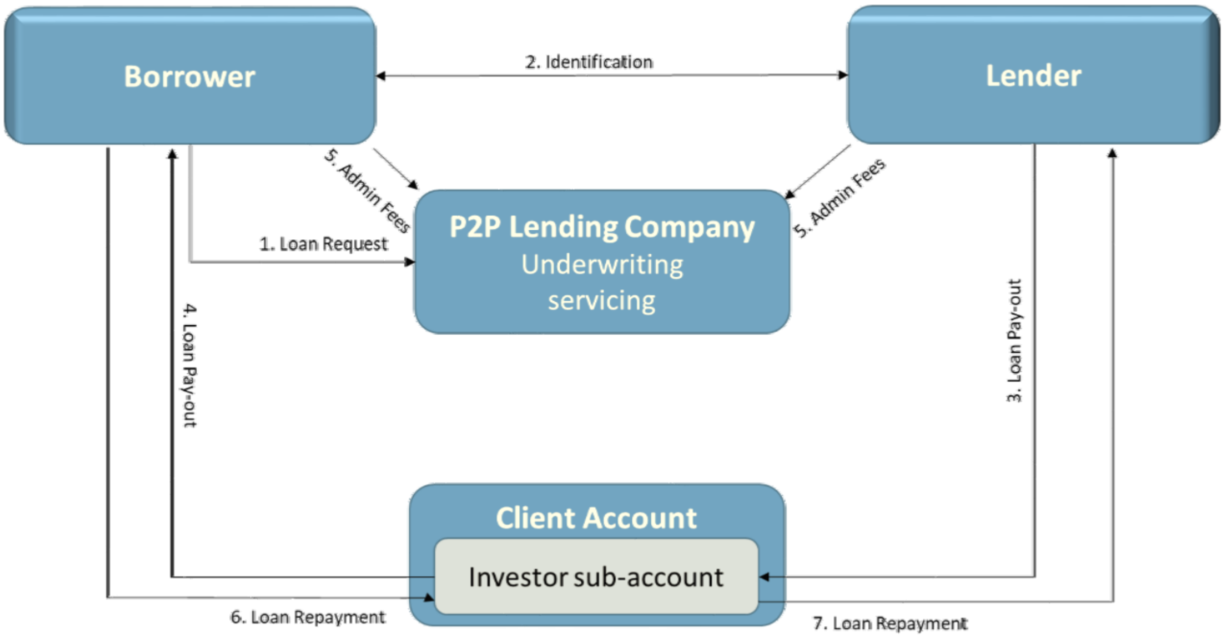

FIGURE 2: CLIENT-SEGREGATED ACCOUNT MODEL- GRAPHICAL REPRESENTATION

This is the simplest form of P2P model, where the lenders directly interact with the borrowers and they themselves fix their counter parties.

The process of client-segregated accounts model is briefed below:

1. The borrower first puts in a loan request on the P2P site;
2. The loan request is then listed on the P2P website for the lenders to identify and act on the loan request;
3. After successful identification and assessment of credit worthiness and various other factors related to the borrower, the lenders then releases the funds in favour of the borrowers, which are deposited into a specific account called the Investor Sub-Account maintained with the P2P, there is a separate investor sub-account for each and every client (lender and borrower);

4. Release of funds in favor of the borrower, is acceptance of the borrower's request for the loan;
5. These funds are then transferred into the Investor Sub-Account of the borrower for him to put to use;
6. On the remittance of the funds between the lender and borrower, the P2P usually deducts its loan origination charges/ administration fee, fees charged for using the platform, by whatever nomenclature it may be called, from both of the clients;
7. At time of repayment, the borrower repay the amount by depositing the same into its Investor Sub-Account from where it travels into the lender's accounts;
8. While these accounts are operated by the lenders and borrowers themselves usually, but the information pertaining to flow of funds is routed through the P2P portal.

This form of P2P model is very transparent as both the parties have complete knowledge of flow of funds. Here the lenders do not face any risk of losing their money in the event of bankruptcy of the P2P company as there is a direct agreement between the lender and the borrower, neither does the P2P faces any risk of claims from the lenders in case of default of the borrowers, as the lenders use discretion for making lending decisions.

NOTARY MODEL

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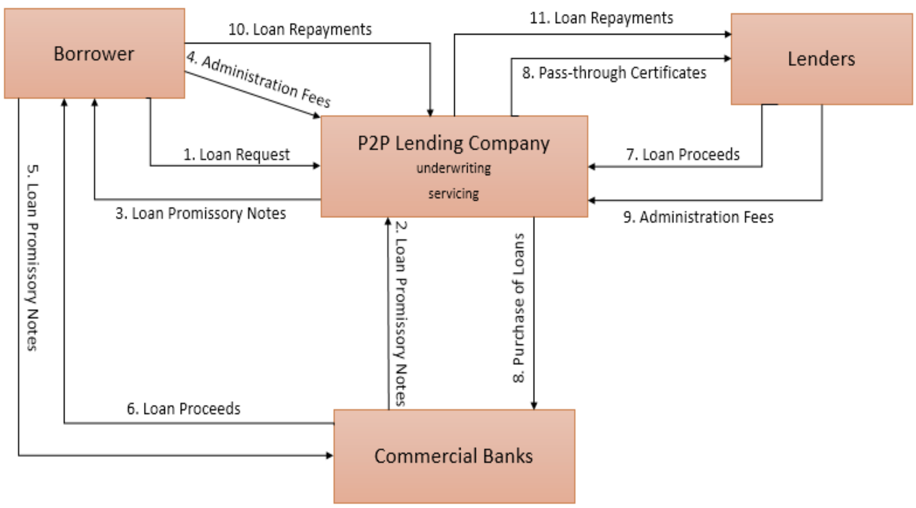


FIGURE 3: NOTARY MODEL-GRAPHICAL REPRESENTATION

This is a much complex form of P2P business, which involves a commercial bank apart from the lender or the borrower.

The process of the notary model is briefed below:

1. The borrower first put in their loan request on the P2P site;
2. The P2P then forwards the loan request to a commercial bank associated with the P2P, the bank then sanctions the loan and issues a note promising to pay the debt to the P2P;
3. The P2P then forwards the note to the borrower;
4. The P2P then charges its fees from the borrower;
5. The borrower submits the promise note to the issuing bank;
6. The bank in return pays the promised loan amount to the borrower;
7. Meanwhile the P2P lists the loan request on its website, for the lenders to view them and advance funds to finance the loan request;
8. Once there are sufficient funds with the P2P from the lenders, the P2P immediately buys the loan receivables from the lending bank and issues certificates representing debt converted into tradeable units to lenders in proportion to the funding extended by the lenders to the loan.
9. At this time, the P2P charges its administration fees from the lenders.
10. At time of repayment of the loans, the borrowers pays the lenders through the P2P.

Essentially the loan origination is through a bank which acts as a vehicle to convert the loan into tradeable units which are then subscribed by the lenders on the P2P platform.

This form of P2P model is advantageous to the borrowers as they do not need to wait for a lender to identify him/her and advance them loans, instead the P2P helps the borrowers by facilitating the banks to originate the loans and later converting the loan into a P2P loan. This is the model used by the industry leaders like Lending Club and Zopa.

GLOBAL OVERVIEW

PERFORMANCE OF P2P LENDING GLOBALLY

Touching a global high of around £ 46,706 millions in terms of lending volume in 2019[10], the P2P industry is showing no signs of stopping as it gears up to give banks a run for their money (literally). The first ever P2P was Zopa. A U.K. born company established in 2005 that introduced this idea of raising funds from any common person around the world that had idle money lying with him. United States, seeing the rise of such a business model, introduced Prosper and LendingClub in 2006, two of the heavyweights in today's scenario as well. China too cloned this structure, with the P2P story mushrooming in the year 2007.

As per a research [11] conducted by S&P Global Market Intelligence, loan origination through P2P in UK amounted to £5.7 billion in 2018. Further, AltFi reports[12] annual lending of £6.17 billion in UK in the year 2019.

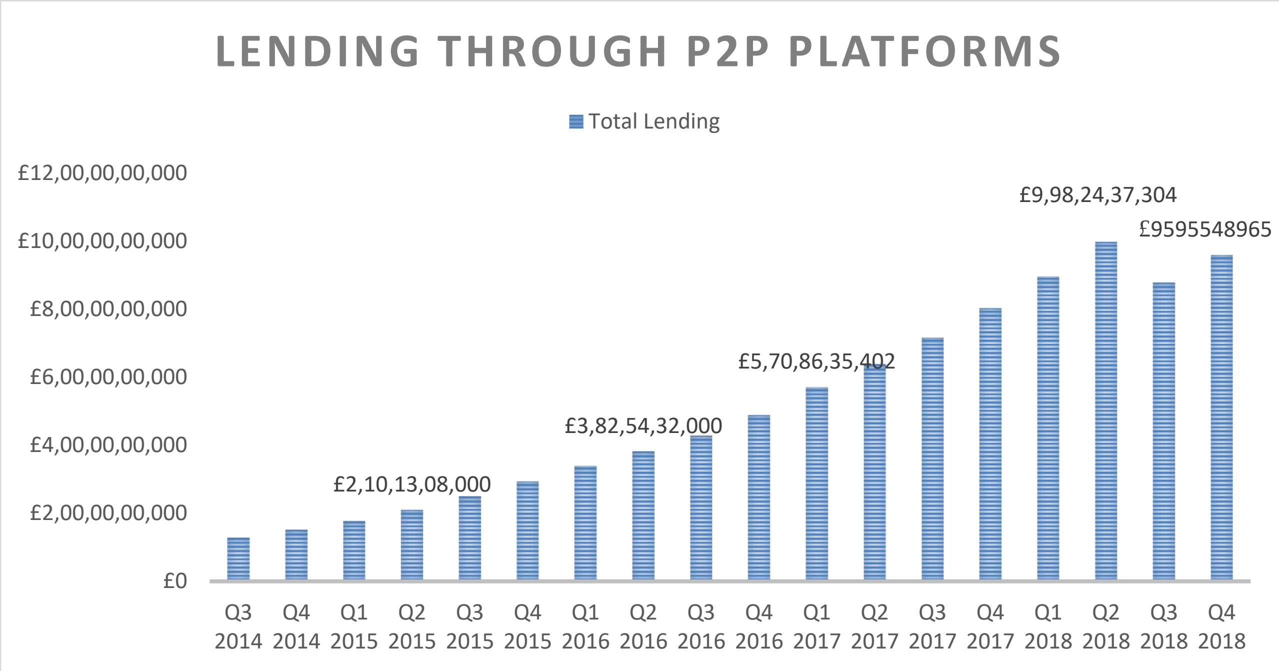
The cumulative loan origination volumes grew at a CAGR of 175% between the first quarter of 2005, when Zopa Ltd. launched the industry into existence, and the first quarter of 2019.

Further, statistics show that, the global P2P Lending Market is valued at USD 34.16 Billion in 2018 and expected to reach USD 589.05 Billion by 2025 with a CAGR of 50.2% over the forecast period, mainly led by China.

The marketplace lending (consumer) segment is expected to have 36,622.6 thousand users by 2023[13]. The cumulative lending among P2PFA platforms has now exceeded 5.5 billion pounds for businesses, and 4 billion pounds for consumer lending.

The lending volumes through P2P interface have been on a constant rise as also indicated by the graph below:

[10] https://www.p2p-banking.com/?s=International+P2P+Lending+Volumes+december+2019
[11] https://www.spglobal.com/marketintelligence/en/news-insights/research/uk-peer-to-peer-loan-volumes-show-robust-growth-despite-rising-headwinds
[12] https://www.altfi.com/state-of-the-market
[13] https://www.statista.com/outlook/338/100/marketplace-lending--consumer-/worldwide



Source: P2PFA

With a growth rate of 52% annually[14], P2P industry has a very promising future as Fintech is being promoted and accepted worldwide. With the global economic scenario conducive to its growth, the number of small enterprises and prospective investors looking for higher and customized returns is only increasing. As internet penetration increases, the market size of the P2P players will increase even further as prospective borrowers look for cheaper and much more relaxed terms to raise funds. With every passing day the P2P industry seems to be improving as companies pass more stringent terms and offer additional services to win over public confidence.

While the lending on the platform in percentage terms continues to be quite insignificant to the size of the market, whether in the U.K or the U.S, and small in comparison to lending by banks, but as illustrated graphically the volumes are on a rising trend world-over.

The P2P business has spread in various countries and is fast catching up in others. It accounts for more than 70% of all crowd-funding activities worldwide, as per report by CrowdExpert.[15]

The U.S. is the largest industry to date followed by China and Europe. P2P industry caters to various avenues, credit to its wide and skilled investor base. Some of the most prominent fields include small enterprises, student loans

[14] https://www.theroute-finance.com/global-p2p-market-grow-52-annually/
[15] http://crowdexpert.com/crowdfunding-industry-statistics/

and auto loans. We bring out the performance of P2Ps in some of the countries to get a better perspective on the industry world-over. [16]

United States of America:

USA has played a major role in the rise of P2Ps globally since their introduction in 2006. LendingClub, Prosper, OnDeck and Upstart are some of the household names in the P2P sector, registering astronomical growth rates annually thanks to the advanced and tech-savvy domestic environment and distinct regulatory reform. The financial crisis of 2008 was a blessing in disguise for these P2P companies as it offered much higher and stable return on investments and an avenue that was immune to illiquidity. Since most banks outright rejected loan seekers, P2P offered them a way out and this has been one of the most important phenomena leading to its growth.

LendingClub is the largest P2P platform globally. From initiation of operations to the end of 2019, LendingClub facilitated US $50 billion of loan originations and has achieved over 3 million customers.[17] As of 31st December, 2018, LendingClub reported in its 10K filings a delinquency rate of 3.5%, as compared to 3.8% as on 31st December, 2017.[18] The historical average default rates across various loan grades totalled to around 5.14%.[19]

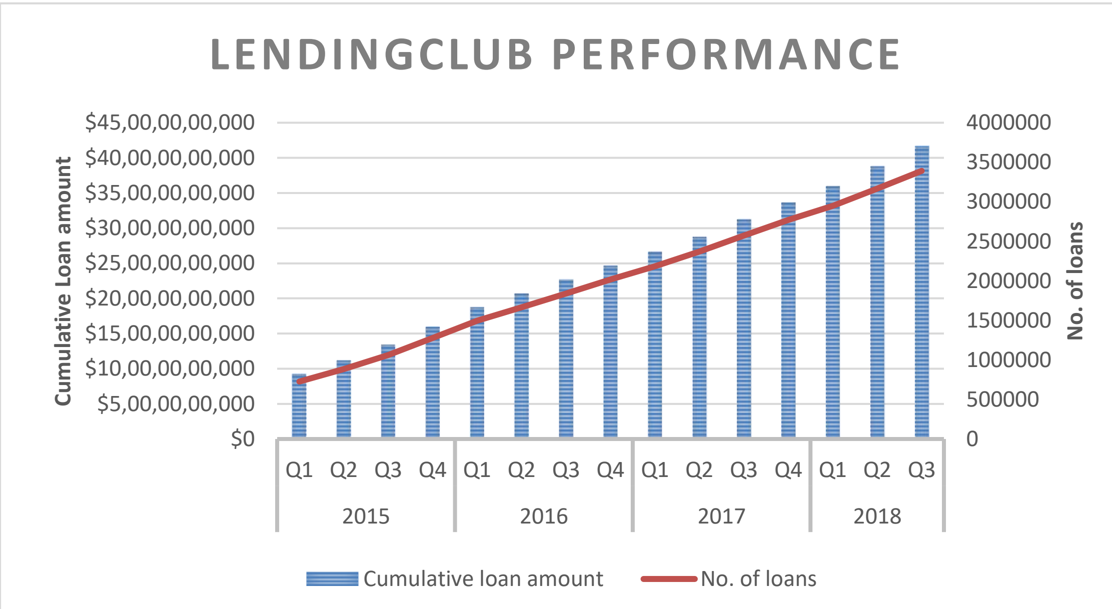


Figure 4: Periodic Performance of LendingClub

[16] http://blog.peerform.com/2017-peer-to-peer-lending/

[17] https://www.lendingclub.com/

[18] http://www.annualreports.com/HostedData/AnnualReports/PDF/NYSE_LC_2018.pdf

[19] http://www.investmentzen.com/peer-to-peer-lending-for-investors/lendingclu

Prosper, meanwhile, is the second largest P2P player in the US - with total loans since origination in 2005 being around $16 billion[20] .

A relatively new entrant, UpStart, has gained a lot of traction in a very small time due to its minimal delinquency rate of only around 8%, much less than its competitors, while issuing around USD 5.8 billion from its inception to the end of 2019.[21]

These 3 companies lead the US market, accounting for a total loan origination of around USD 24.068 billion in 2019[22]. Their major avenues of lending include refinancing of already existing loans, accounting for around 46% of loan portfolio of LendingClub, credit card loans, home improvements, medical and educational loans.

The reason for such strong performance by these companies has to do with the acceptance of public of P2Ps as a mainstream source of raising funds, treating them like banks that operate online and are much less cumbersome and financially efficient. Furthermore, the P2P companies themselves have been very diligent and judicious in giving out loans, carrying out various background checks and factoring in Fair Issac Corporation (FICO) score as well as current income and many more. Some companies such as UpStart are even more meticulous as they analyze careers of individuals, their spending patterns and day-to-day regularity as well. Introduction of innovative policies to propagate company name as well as raise funding is another source of marketing for these companies, example being Prosper linking up with local banks to trade its loan in secondary markets, which will add liquidity to its operations as well.[23]

Offering rates much lower than banks makes it an attractive option for individuals as it has been constantly offering return on investments of 7-8% in a very short time-period, something the banks can never offer in a lifetime.[24]

Such keen and prudent analysis helps build public confidence and translate to prominence in the global financial market. Strong regulatory framework, focused approach of the government and ensuring a safe return in case of a financial crisis have contributed to its popularity. The Securities and Exchange

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[20] https://www.prosper.com/about-us/media/2018/08/13/prosper-reports-second-quarter-results-13-billion-loans-originated-since-inception/
[21] https://www.upstart.com/about#who-we-are
[222222] https://learnbonds.com/news/top-5-countries-by-p2p-lending-volumes-in-2019-report/
[23] https://www.lendacademy.com/prosper-announces-partnership-consortium-160-community-banks/
[24] https://www.lendacademy.com/my-returns-at-lending-club-and-prosper/

Commission (SEC) is the regulatory head of P2Ps in the country, with LendingClub being a listed entity as well. The US government allows various states to implement independent laws as well.

United Kingdom:

FundingCircle, Zopa, RateSetter and LendingWorks are few of the prominent P2P players in the UK market that have helped the UK P2P industry record rapid increase in volume. The P2P market is reported to be worth around $8.03billion in 2019.[25] The market leader in UK has been FundingCircle that has, since origination in 2010, lent £5.8 billion to around 77,000 small British businesses.[26] The average age of loans being reported is around 3 months, majorly funding small businesses. Trailing it, Zopa has reported a figure of £5 billion[27]. It usually provides returns ranging between 3.4 to 6% to investors on the platform.

The reason why P2Ps are now a key player in the U.K. financial environment is because of governmental push and smart investing decision by lenders, who have constantly reported 6-7% returns on investment.[28]

In 2011, three of the main P2P players- FundingCircle, Zopa and RateSetter- came together to form P2P Financial Authority(P2PFA), ' as a self-regulatory body for the sector to promote high standards of conduct and consumer protection'[29]. Additionally, constant government support such as regular investment in P2P and through P2P platforms have boosted its growth.[30] The introduction of Innovative Finance Individual Savings Account (IFISA) helped give a push to P2P industry due to its tax-advantaged status. With around 17 platforms approved to offer the product, it is expected to bring inflow of cash into the system. Founder of Crowd2Fund Chris Hancock revealed that the instrument has led to 667% increase in funds of the company.[31]

The increasingly attractive returns and related benefits such as diversification and low delinquency have all facilitated the rise of such companies, leading to the UK government bringing it within its regulatory ambit. On 1st April, 2014 the Financial Conduct Authority (FCA) became the regulator for the P2P industry.

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[25] https://www.altfi.com/state-of-the-market
[26] https://www.fundingcircle.com/uk/
[27] https://www.zopa.com/invest
[28] https://viainvest.com/blog/uk-p2p-lending-matures-into-a-key-market/
[29] http://p2pfa.info/about-p2p-finance
[30] https://www.gov.uk/government/news/new-40-million-investment-by-british-business-bank-to-support-450-million-of-lending-to-smaller-businesses
[31] http://www.businessinsider.com/uk-peer-to-peer-platforms-are-benefitting-from-government-policies-2016-8?IR=T

CHINA:

With the highest amount of P2P operators, the Chinese were home to more than 4000 platforms in the world (2000 have been deregistered), in 2017. In 2018, growth of China's P2P lending sector dramatically reversed, resulting in a great fall in the number of P2P lending platforms. At the end of October 2019, the number of P2P platforms has reduced to a historical low of 572 and loan transaction volume to £6.37 billion. Lufax, Ppdai.com, Credittease.cn, WeLab and Yirendai are some of the major players in this segment. Negligence from the large state-owned banks towards small and growing industries, large population and a high loan yield are some of the reasons behind the booming growth of this sector. Although the history of this space has been marred by controversy- with P2P player Ezubao being at the helm of a Ponzi scheme, that wiped away 50 billion yuan worth of money that belonged to around 900000 investors- it hasn't stopped the Chinese P2P market from spreading even wider. The Chinese government, seeing the meteoric rise of the industry, introduced regulatory reforms in 2016, with amendments being made to it as well, in order to win back investor confidence.

P2P REGULATIONS GLOBALLY

Such has been the rise of this ecosystem that the regulatory bodies have had to take note of them worldwide and introduce regulatory guidelines in order to bring stability, transparency and credibility to this sector. The table below indicates the regulations applicable in various countries:

Country	Year of origination	Regulatory scenario in brief	Regulations

United States of America	2006	P2Ps are regulated by SEC. While SEC would monitor the lending-investing procedure, agencies like Consumer Financial Protection Bureau (CFPB) and Federal Trade Commission (FTC) would monitor the borrower side of operations. The states are allowed to apply different laws as per their suitability. Certain states like Texas have completely banned P2P business while some have placed restrictions on their financial capacity. SEC had cumbersome regulations in place which included listing of companies, shelf-registration of loans and uploading disclosures as per SEC's EDGAR (Electronic Data Gathering, Analysis and Retrieval system); it led to LendingClub to close operations for a year. The regulations by SEC made the loan disbursal process costlier and sophisticated.	Securities and Exchange Commission (SEC) and State specific regulations
United Kingdom	2005	The FCA is the regulatory body, governing the activities of P2P companies since 1st April, 2014. It stipulates that the company be treated only as an intermediary and nothing more. The downfall of Quakle alerted the FCA and was a clear indication that the regulations were far too relaxed and flexible in nature. To improve this framework, it decided to introduce a flurry of P2P laws [32] to improve its structure, some of the major ones being- introduction of a 'reserve' or 'provision fund' in order to reimburse the lender in case of default by the borrower. The UK FCA has issued recommendations for changes to P2P lending regulations for loan-based crowdfunding platforms. Based on FCA's findings it invited responses to changes for loan-based firms which covers proposals to ensure investors receive clear and accurate information about a potential investment and understand the risks involved and to promote good governance and orderly business practices.	Financial Conduct Authority (FCA)
China	2007	The downfall of Ezubao was one of the reasons why China rushed to bring this booming industry under its purview. The regulations pre-Ezubao were lax and is cited as a reason for instance like Ezubao to	China Banking Regulations Commission (along with

[32] https://www.fca.org.uk/publication/feedback/fs16-13.pdf

		have occurred. CBRC amended the regulations to make them stricter. P2P companies have to file documents with the relevant local financial supervisory authorities and are under regular supervision. Periodically lender-borrower transaction details are to be released to the regulators to ensure transparency. One of the major stipulations was that it will have to maintain a separate account of its own funds from that of the lenders and borrowers, thus ensuring they cannot disguise the flow of money. P2Ps have been prohibited from accepting public deposits, providing guarantee on returns and issuing asset backed securities to transfer debt. Further, an individual cannot borrow more than RMB 200000 from a single platform and RMB1 million in total from multiple platforms. The changes were introduced to reinstate confidence in P2Ps.	Cyberspace Administration of China and Ministry of Industry and Information Technology)
Australia	2012	Australian guidelines regard P2Ps as Managed Investment Scheme (MIS). They are required to hold an Australian Financial Services (AFS) license and an Australian Credit License. It is currently in a 'regulatory sandbox' program.	Australian Securities and Investment Commission(ASIC)
Canada	2016	Most P2P companies in Canada are allowed to sell the loans financed by them as securities. This leads to them falling under the ambit of Securities Act issued by the Ontario Securities Commission (OSC)[33]. The regulation of P2Ps in Canada is unclear, sophisticated and over-lapping in nature as the Commission itself is undecided on which laws and acts the P2Ps should follow given the diverse nature of activities and structure of the platforms.[34]	Canadian Securities Adminstrator (CSA)

[33] http://www.mondaq.com/canada/x/494406/Financial+Services/PeerToPeer+Lending+And+The+Future+Of+Alternative+Finance+In+Canada

[34] https://beta.theglobeandmail.com/report-on-business/osc-warns-peer-to-peer-lenders-may-be-subject-to-securities-regulation/article25046026/?ref=http://www.theglobeandmail.com&

Japan	2008	No laws govern P2P platforms in particular and Marketplace Lending in general in Japan. The Securities Act, which demands transparency, collides with the Lending Business Act, which restricts identity or information disclosure. This leads to an opaque and unregulated legal environment in the country.[35]	-
Israel	2014	Israeli P2P companies that were previously prohibited in the country, will now be governed by the Supervision of Financial Services Law that will come in effect from 1st February, 2018.[36]	
Germany	2007	P2P companies in Germany have flourished despite very strict banking laws being levied on them. The German Banking Act (Kreditwesengesetz-KWG) is applicable to P2Ps as well. This Act stipulates that only banks may raise loans in the country, meaning P2P companies have to partner with banks, request a loan and then sell the title to the investor. This makes P2P business a tedious ordeal.	Federal Ministry of Finance (Bundesministerium der Finanzen)
India	2012	See below.	Reserve Bank of India

Source: Authors data collation

[35] https://www.lendacademy.com/marketplace-lending-japan/

[36] https://www.lexology.com/library/detail.aspx?g=d2a40316-92cd-4551-9706-9df4fe0c7ff1

FAILURES IN P2PS BUSINESS

Having now found a humble standing in the financial space, the journey of P2P Platforms also witnessed massive failures, which further led to a conservative and apprehensive approach, resulting to stringent regulations.

Initially, there were doubts regarding the transparency of flow of money from the lender to the borrower. The high rate of return and ease of access seemed to be too good to be true - and it turned out to be so for countries like the U.K. and China who burnt hands and witnessed some failures.

CHINA:

EZubao, formed in 2014 by the Yucheng Group, was one of the largest P2P player in China, raising around 50 billion yuan in just 1 and a half years of operation. It offered returns of around 9-15%, with no limits on the amount or tenure of deposit. The flaw in this scheme was discovered when it was found that the scheme cannot be sustained - leading to the Chinese government suspending its operations and launch an investigation against the company. The company owner, Ding Ning, openly declared on public TV that the company was using lender's funds for its own personal cause. He used to withdraw a monthly salary of 1 million yuan and stated that the he was using the Ezubao funds on himself. Over 95% of the projects carried out by the company were fake, used to pay off old debts, and they used various off-shore construction projects, one of them being construction of a bank in Myanmar. The company concealed its activities by spreading it across 200 computer servers scattered in various locations and even hiding accounting data by burying around 1200 books six metres into the ground. It was later rightly discovered that the company was a Ponzi scheme, leading to the arrest of at least 21 company executives.

All this happened because there were no definitive laws to govern this growing space, with the companies acting and operating however they liked and with the absence of any disclosure reforms, the public were duped in a big fashion, having no idea where their money was flowing. It was a case of lesson learnt as the People's Bank of China sat down with other related bodies and brought the P2P sector within its regulatory purview. It released a set of guidelines, putting restriction on the amount of public deposits, reserves and other disclosures the company had to maintain.[37]

According to Online Lending House, 4500 platforms have collapsed since 2013[38] on account of disclosure non-compliance, fraud activities or managers simply disappearing due to suspicion by the government.

United Kingdom:

U.K. too had to pay for its ignorance, but the cost was marginal compared to China's. Quakle, a year old company, became insolvent due to 100% defaults in loans lent out to unworthy borrowers. The FCA released a statement declaring the bankruptcy of Quakle and the reasons for it as well.[39] The fact that it had very relaxed credit assessment norms and that it was not focused on maintaining credibility but rather expanding was the reason for its downfall. Thankfully it had only a few 100 customers. This incident was only a warning sign for the UK to introduce regulatory supervision to bring about stability in the sector, going forward.

Other platforms that closed down include BigCarrots, Squirrl.com and YES-secure. YES-secure, which lured savers by promising returns of up to 18%, shut down in March 2014 before a regulatory crackdown. The Company returned all the money it had attracted

[37] http://fortune.com/2016/08/24/china-p2p-lending-regulation/
[38] https://www.livemint.com/Money/tuI4wvfqdbVH9nQVYC1M5I/Lessons-for-P2P-lending-in-India.html
[39] https://www.fca.org.uk/publication/final-notices/quakle-limited.pdf

P2PS IN INDIA

REGULATIONS IN INDIA

MASTER DIRECTIONS, 2017

The Reserve Bank of India issued a Master Directions – Non Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017 (hereinafter referred to as "Directions") on 4th October, 2017, which is an extensive statement outlining in detail the various rules and regulations that all existing and prospective entities carrying on or intending to carry on the business of Peer-to-Peer (P2P) lending (hereby known as NBFC-P2P) will have to comply with. These Directions shall come in force with immediate effect and shall apply to all NBFC-P2Ps, i.e. with effect from the date of issuance of the Master Directions, mentioned above.

REGISTRATION

ELIGIBILITY CRITERIA

The basic eligibility criteria for carrying on the business of setting up a P2P lending platform are as follows:

- Only a Non-Banking Financial company shall undertake the business of P2P lending platform.
- All NBFC-P2Ps that intend to either commence or carry on the business of Peer-to-peer lending platform must obtain a Certificate of Registration (CoR) from RBI..
- Every existing and prospective NBFC-P2P must make an application for registration to the Department of Non-Banking Regulation, Mumbai of RBI.
- Any company seeking registration as an NBFC-P2P must have Net Owned Funds of at least Rs. 2 Crores or higher as RBI may specify.
- The RBI has imposed the condition that the company seeking registration must be incorporated in India and must have a robust IT system in place. The management must act in public interest and the directors and promoters must be fit and proper.

While the eligibility criteria remains same for those already into business and prospective ones, however, there is a slight difference in the way the application process of these two categories will be dealt with by the RBI.

PROSPECTIVE P2PS

An entity intending to set up a P2P lending platform will have to make an application for registration to the Department of Non- Banking Regulations of

RBI, and at the time of making the application, it should achieve net-owned funds of Rs. 2 crores which must be parked into Fixed Deposit.

Upon submission of the application, if the RBI is of the view that the aforesaid conditions have been fulfilled, it will grant an in-principle approval for setting up of a P2P lending platform, subject to such conditions which it may consider fit to impose. This approval will be valid for a maximum of 12 months from the date of granting of the approval. Within this period of 12 months, the company must put in place the technology platform, enter into all other legal documentations required. We are of the view that during this period, the entity will be allowed to break the fixed deposit and utilize that money to incur capital expenditure as the ones mentioned above. The entity will have to report position of compliance with the terms of grant of in-principle approval to the RBI.

Once the systems are in place and the RBI is satisfied that the entity is ready to commence operations, it shall grant the Certificate of Registration as an NBFC–P2P.

This high NOF requirements and the long gestation can deter prospective players from entering into the market.

Existing P2Ps

The situation will be different for entities who are already into the business. Any entity carrying out the business of Peer-to-peer lending platform as on the effective date of these Directions, can continue to do so provided that they apply for registration as an NBFC-P2P to the RBI within 3 months from the date of effect of these Directions. This will however, not hamper their business, as the RBI allows them to carry on the business, during the pendency of the application and until the application for issuance of CoR is rejected. If the application is rejected, the applicant will have to wind up its business.

Scope of Activities

The Master Directions, next, discuss about the Dos and Don'ts of the P2P lending platforms. Let us first discuss about the Dos.

Dos

An NBFC-P2P can only act as an intermediary that provides an online platform to the participants, i.e., borrowers and lenders, involved in P2P lending. It should ensure adherence to legal requirements applicable to the participants as prescribed under relevant laws, which means this includes the KYC Directions prescribed by RBI. It is also required to store and process all data relating to its activities and participants on hardware located within India. It is permitted to invest in instruments specified by RBI provided they are not traded in.

Another important function that has been added to the scope of the NBFC-P2P credit assessment and risk profiling of the borrowers, the findings of which must be disclosed to the prospective lenders. Earlier, only few of the platforms carried out underwriting on behalf of the lenders, but, henceforth, this is something that a platform will have to carry out mandatorily.

Dos:

- *Act only as an intermediary;*
- *Ensure adherence to legal requirements applicable to the participants;*
- *Store and process all data relating to its activities and participants;*
- *Undertake due diligence of participants;*
- *Undertake credit assessment and risk profiling of the borrowers and disclose the same to their prospective lenders;*
- *Undertake documentation of loan agreements and other related documents;*
- *Render services for recovery of loans originated on its platform.*

In addition to the above, NBFC-P2Ps will have to get themselves registered with all the Credit Information Companies (CICs) in the country and file the creditinformation (relating to borrowers), and update them regularly on a monthly basis or at such shorter intervals as may be mutually agreed upon between the NBFC-P2P and the CICs.

NBFC-P2Ps shall also ensure that appropriate agreements are executed between the participants and the platform, which should categorically specify the terms and conditions agreed between the borrower, lender and the platform. The interest rates to be charged on the loans must be displayed in Annualized Percentage Rate (APR) format on the website of the platform.

DON'TS

Don'ts:

- *Not raise deposits;*
- *Not lend on its own;*
- *Not provide or arrange any credit enhancement or credit guarantee;*
- *Not facilitate secured loans;*
- *Not hold on its own balance sheet any funds received from lenders and borrowers;*
- *Not cross-sell any products on its platform except for loan specific insurance products;*
- *International flow of funds is prohibited*
- *Not release credit information*

Despite being an NBFC, NBFC-P2Ps are prohibited from lending on its own. It shall ONLY act as an intermediary and nothing more. It should not provide or arrange any credit enhancement or credit guarantee and also all loans intermediated must be purely unsecured in nature. It is required to maintain an escrow account to transfer funds and should not hold on its own balance sheet any funds received from lenders for lending, or from borrowers for repayment. It is prohibited from cross-selling any product on its platform except for loan specific insurance products. International flow of funds is also not permitted for NBFC-P2Ps.

During surveys we have observed that some P2Ps have been engaged in lending through their own platforms. This will have to be stopped now. P2Ps are not allowed to carry on any other activity other than P2P loan intermediation. This is much stricter regulation than for any other type of NBFC. Mortgage guarantee companies are allowed to take up any other activity up to 10% of its total assets. All other NBFCs must in general satisfy the principality requirements- at least 50% of its total assets must be financial assets and at least 50% of its total income must be from these assets. This is far more lenient than that being allowed for P2Ps.

PRUDENTIAL NORMS

Like all other Directions issued by the RBI for NBFCs, these Directions also lay down the prudential regulations for this class of entities. They are as follows:

- Leverage: The outside liabilities of a platform must not exceed 2 times of its owned funds;
- Concentration limits: The Directions provide for several concentration limits, which are:
  - Maximum that a single lender can lend across all P2P platforms – Rs. 50 lakhs, provided the same is consistent with the lender's net-worth;
  - Lender investing more than Rs. 10 lakhs shall produce a certificate to P2P platforms from a practicing Chartered Accountant certifying minimum net-worth of Rs. 50 lakhs.
  - Maximum that a single borrower can borrow across all P2P platforms – Rs. 10 lakhs;

  Maximum that a single lender can lend to a single borrower across all P2P platforms – Rs. 50,000;One apparent concern that we can point out in this regard is as follows:

  Say for instance, a borrower requires a funding of Rs. 5 lakhs, in such case, the platform will have require at least 20 lenders empanelled with itself to meet the requirements of the borrower. Thus, the platforms will have to have large lender base to survive and be able to satisfy loan requirements of borrowers. Therefore, the success of the platforms will be directly related to the scalability of their business.

  The P2Ps are also required to obtain a certificate from the borrower and lender, as applicable, that the aforementioned limits are being adhered to.

- Tenure: The tenure of the loans extended through the platforms cannot exceed 36 months.

Operational Guidelines

An NBFC-P2P is required to have a Board approved policy in place specifying the eligibility criteria, pricing of services and rules for matching participants on its platform.

The Directions explicitly state that the obligation of an NBFC-P2P does not diminish towards those activities that it has outsourced. It will be held responsible for the actions of its service providers including recovery agents and the confidentiality of information pertaining to the participant that is available with the service provider.

The Master Directions was updated on February 23, 2018 and the provision of appointing a Nodal Officer/ Principal Nodal Officer was inserted. The provision states that the NBFCs which are covered under the Ombudsman scheme for NBFCs, 2018 shall appoint a Nodal Officer/ principal Nodal Officer as per the Directions. However, the scheme is currently applicable only for all deposit accepting NBFCs and based on the experience gained, the Scheme would be extended to include the remaining identified categories of NBFCs.

OUTSOURCING GUIDELINES

The outsourcing guidelines was released by RBI on November 9, 2018. The directions shall apply to all 'Material Outsourcing Agreements' undertaken by these NBFCs. Material Outsourcing Agreements means those agreements upon which the business of the NBFC is highly dependent on. The directions lays down certain activities which cannot be outsourced. It states that an NBFC cannot outsource its core management functions including Internal Audit, Strategic and Compliance functions and decision-making functions such as determining compliance with KYC norms for opening deposit accounts, according sanction for loans and management of investment portfolio. Further, the Directions states that NBFC P2P shall conduct a self-assessment of their existing outsourcing arrangements.

FURNISHING INFORMATION TO CREDIT INFORMATION COMPANIES (CICs)

An NBFC-P2P shall become member of all CICs and submit data (including historical data) to them. Further, it shall also ensure the following:

(i) credit information (relating to borrower transactions on the platform) is maintained by it and updated regularly on a monthly basis or at such shorter intervals as may be mutually agreed upon between the NBFC-P2P and the CICs;

(ii) that it takes all such steps which may be necessary to ensure that the credit information furnished by it is up to date, accurate and complete;

(iii) that it includes necessary consents in the agreement with the participants for providing the required credit information

TRANSPARENCY

The Directions has provided for one way transparency. On one hand, it states that the NBFC-P2Ps must disclose to the lender details about the borrower including:

- personal identity;
- required amount;
- interest rate sought; and credit score as per the P2P's credit rating mechanism;
- terms and conditions of the loan, including
  - likely return; and
  - fees and taxes associated with the loan.

On the other hand it requires the NBFC-P2Ps to make the following disclosures to the borrowers:

- amount of loan proposed by the lender
- the interest rate offered by the lender etc.

However, it restricts the platform to give out the personal identity and contact details of the lender to the borrower.

Therefore, the Directions provide for full transparency with respect to borrower's information but partial transparency with respect to lender's information.

Apart from information of the participants, the Directions require the platforms to provide the following information on its website:

a. overview of credit assessment/score methodology and factors considered;
b. disclosures on usage/protection of data;
c. grievance redressal mechanism;
d. portfolio performance including share of non-performing assets on a monthly basis and segregation by age; and
e. its broad business model.

SIGNING OF THE LOAN TERMS

One of the requirements of the Direction is that no loan shall be disbursed unless the individual lender has approved the individual recipient of loan and all the concerned parties have signed the loan contract.

Here it is important to take a note that while signing the terms of loan, sufficient measures must be taken by the platform to ensure that the personal and contact details of the lender continues are not revealed to the borrower, owing to the restrictions imposed by the Directions on the platform with respect to transparency.

FUND TRANSFER MECHANISM

RBI has put a lot of focus on implementing an efficient fund transfer mechanism in order to eliminate any fears of money laundering or usage by the company for its benefit. The Directions stipulate that Fund transfer between the participants on the Peer-to-peer lending platform must take place through escrow accounts which will be operated by a trustee, who must mandatorily be promoted by the bank maintaining the escrow accounts. At least 2 escrows accounts must be maintained - one comprising funds received from lenders and pending disbursal, and the other for collection from borrowers as repayment of loans. All forms of transfer of funds must take place through bank accounts ONLY and cash transactions are prohibited. The graphical representation of the proposed mechanism was included in the Directions, the same has been reproduced below for your reference.

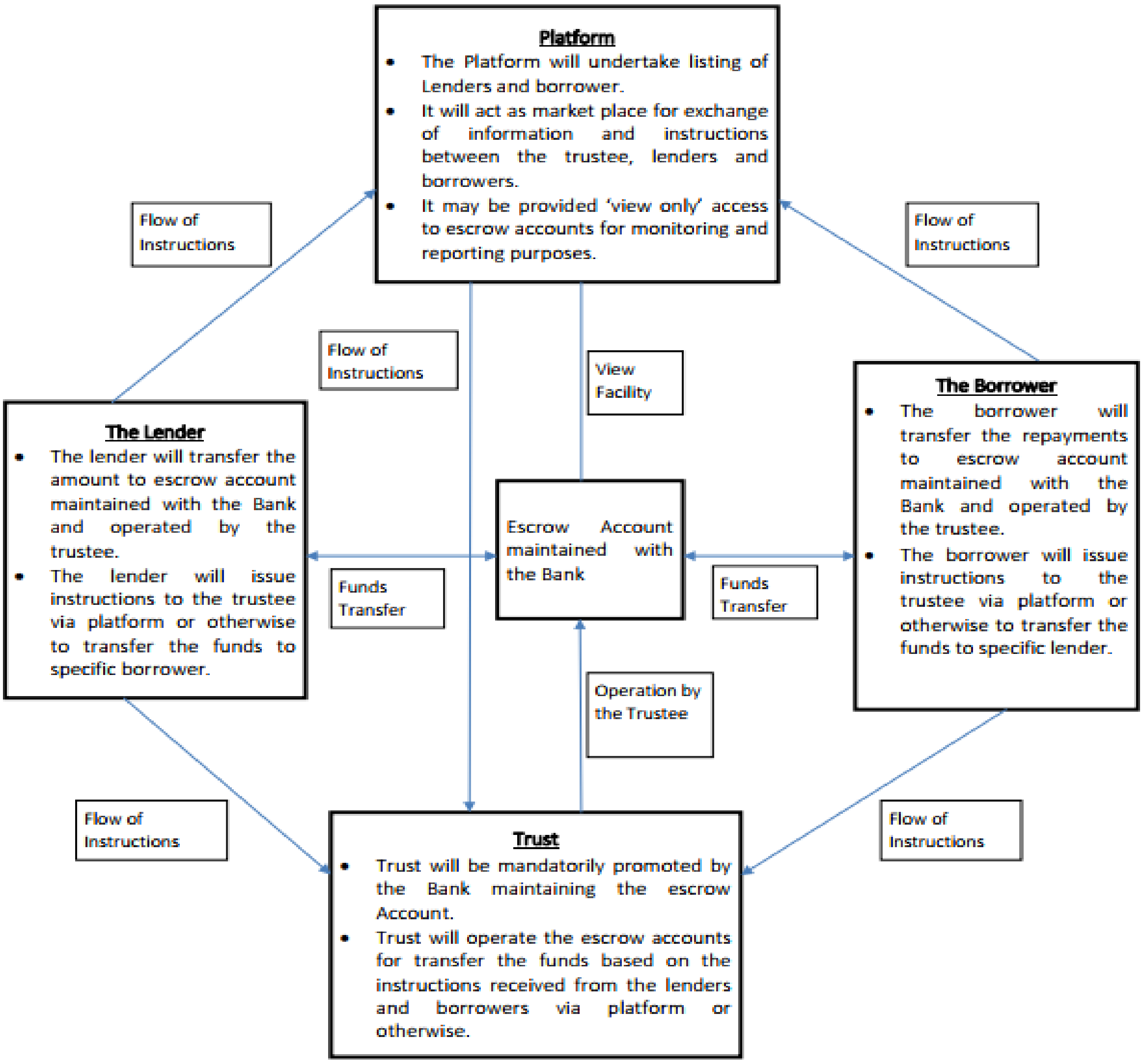


FIGURE 5: FUND TRANSFER MECHANISM-GRAPHICAL REPRESENTATION

The graphic provided on the Directions for the funds transfer mechanism is somewhat ambiguous as it shows only one escrow account, and also shows direct flow of instructions between the lender/borrower and the Trust, which is odd, as it is the platform who should control the flow of information to the Trust.

FAIR PRACTICES CODE

NBFC-P2Ps are required to follow the usual NBFC related Fair Practices Code (FPC) with the approval of its board. They are further required to disclose the same on their website for the information of various stakeholders.
The NBFC-P2Ps are prohibited from providing any assurances on the recovery of loans.

The platform is required to post the following disclaimer on its website -

"Reserve Bank of India does not accept any responsibility for the correctness of any of the statements or representations made or

opinions expressed by the NBFC-P2P, and does not provide any assurance for repayment of the loans lent on it"

The Board of Directors shall also provide for periodic review of the compliance of the Fair Practices Code and the functioning of the grievances redressal mechanism at various levels of management. A consolidated report of such reviews shall be submitted to the Board at regular intervals, as may be prescribed by it.

Information Technology Framework

Given the fact that the core operation of P2P lending platforms depends on a robust IT framework, the Directions state that the technology must be scalable in nature to handle growth in business. The Directions also stipulate that there should be adequate safeguards built in its IT systems to ensure that it is protected against unauthorized access, alteration, destruction, disclosure or dissemination of records and data. The RBI also reserves the right to, from time to time, prescribe technical specifications, as deemed fit. The rest of the IT laws are same as those issued to NBFC-SIs in general.

Fit and Proper Criteria

An NBFC-P2P must ensure that a policy is put in place with the approval of Board of Directors, setting out the 'Fit and Proper' criteria to be met by its directors and also obtain a Deed of Covenants signed by the Directors. RBI may, if it deems fit and in public interest, may independently assess the directors and have the power to remove the concerned directors.
The guidelines have, surprisingly, been kept at par with NBFC-SI. The Deed of Covenants, regular reporting requirements etc. are all observed by NBFCs which are systemically important i.e. NBFCs having asset size of over 500 crores. For P2P platforms to have to observe these is perhaps over-regulation.

Requirement to obtain prior approval of the Bank for allotment of shares, acquisition or transfer of control of NBFC-P2P

Given the fact that most P2P lending platforms are start-ups in nature, the requirements are very restrictive in nature. The Directions stipulate that prior approval from the banks will be required in case of:

a. any allotment of shares which will take the aggregate holding of an individual or group to equivalent of 26 per cent and more of the paid up capital of the NBFC-P2P;
b. any takeover or acquisition of control of an NBFC-P2P, which may or may not result in change of management;
c. any change in the shareholding of an NBFC-P2P, including progressive increases over time, which would result in acquisition by/ transfer of shareholding to, any entity, of 26 per cent or more of the paid up equity capital of the NBFC-P2P;

d. any change in the management of the NBFC-P2P which would result in change in more than 30 per cent of the Directors, excluding independent Directors;
e. any change in shareholding that will give the acquirer a right to nominate a Director

A public notice of at least 30 days shall be given before effecting the sale or transfer of the ownership.

The format for application for prior approval is the same as for other NBFCs. This is quite unprecedented level of regulation and will seriously increase the bureaucracy PE/VC investors and startups have to go through before a funding round can be closed. Even a 1% allotment which takes one's shareholding past 26%, then prior permission will be required. Again, should an investor want the right to nominate a Director, then prior approval will be required. This level of regulation is higher than for regular NBFCs and would slow down the process of investments in P2P platforms in India.

Reporting Requirements

NBFC-P2Ps must submit a statement showing number and amount of loans during, at the closing of and outstanding at the beginning and end of quarter, including the number of lenders and borrowers outstanding as at the end of quarter to RBI regional office within 15 days after the quarter to which they relate.

They must also disclose the amount of funds held in the Escrow Account, with credit and debit summations for the quarter. Further, number of complaints outstanding at the beginning and end of quarter and disposed of during the quarter, bifurcated between the lenders and borrowers must also be disclosed in order to constantly improve the state of the industry.

Some frequently asked questions have been prepared on the RBI regulations, the same forms a part of this report as Annexure I.

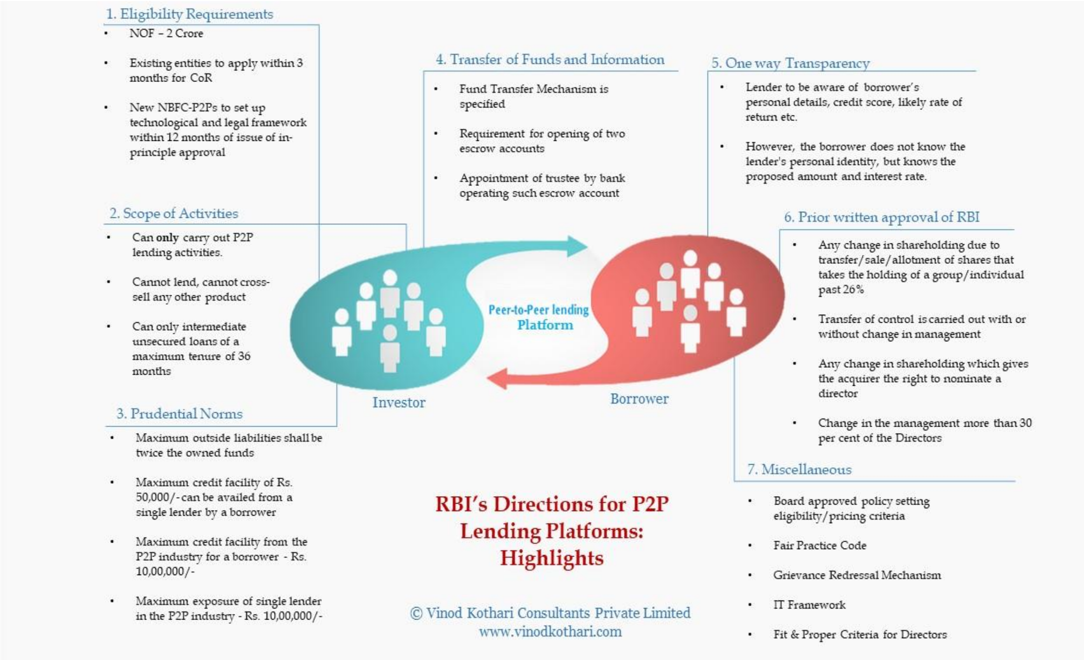


Figure 6: Directions for NBFC P2Ps

Other applicable laws and regulations

In addition to the above, the following existing laws also are applicable and P2Ps should take cognizance of the same while conducting business.

The other regulations that may become applicable depending on the business model are listed below:

a. Deposits regulations;
b. SEBI Collection Investment Scheme Regulations
c. Provisions of Income Tax Act pertaining to tax deduction at source
d. Information Technology Act
e. Evidence Act, etc.

Key Industry Data

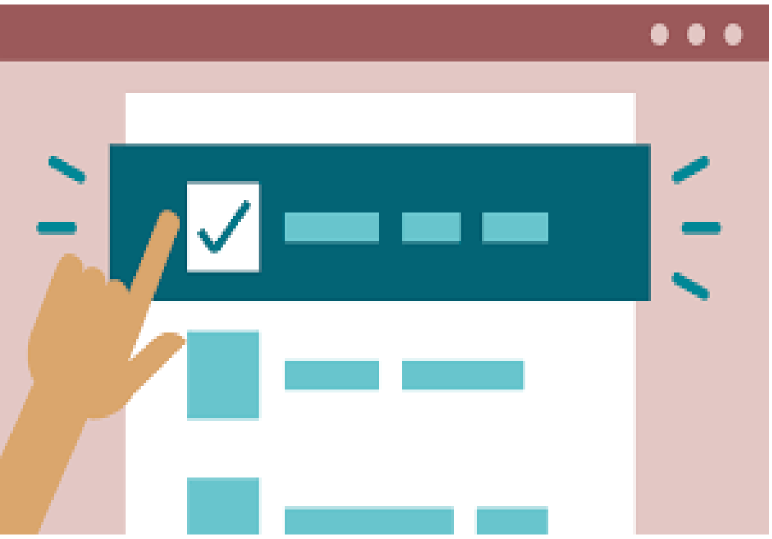
Although, this market is still in its infancy stage and it is too early for any substantial industry volume data to be available, some data is available[40], namely:-

1) The monthly growth in lending is around 20% - 30%
2) The median age of borrowers is between 25 – 35 years
3) Professional and salaried persons have a higher probability of getting funds
4) 100% of the loans given are unsecured

[40] https://www.faircent.com/node/254

The risks are high as business is largely unsecured; the borrower segment is the young India and growth numbers are an indicative a many on the prospects of P2P business in India and the target customer segment.

The Indian market is at a nascent stage and there is barely any data collation being carried out to report for comparative performances. There is, in fact, very little data available on the active P2Ps functioning in the market either.



SURVEY

An interesting survery has been carried out on the viability of P2Ps as an investment avenue in India. The table below is a reproduction of the comparative table:

	Lendbox	Faircent	Lendenclub	i2i	Loanmeet	Monexo	i-lend	Lending Club(US)
Automated Investing	No	No	No	No	No	Yes	No	Yes
E-contracts	Yes	Yes	Yes	Yes	Yes	Yes	NA	Yes
Escrow/Nodal Accounts	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
EMI Statement	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Interest Income Statement	No	No	No	No	No	Yes	No	Yes
Loan stats (platform level)	No	Yes	No	No	No	No	No	Yes
Reconciliation Process Updates	No	No	No	No	No	No	NO	Yes
EMI Transfer To	Bank A/c	Platform Wallet	Platform Wallet	Bank A/c	Bank A/c	Bank A/c	NA	Bank A/C
EMI Transfer On(each month)	11^{th}	Day of deduction	Day of deduction	11^{th}	Day of deduction	5^{th}	NA	NA

EMI Deducted on salary day	No	No	No	No	No	No	NA	NA
Interest Rate Bidding	Open Auction	Reverse Bid	Reverse Bid	Fixed	Open Auction	Fixed	Fixed	Fixed
CIBIL/Experian Reporting	No	No	No	No	No	Yes	No	Yes
Investor Dashboard	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Source: Refer note[41]

Approach and Methodology of the Survey

There is currently no data aggregation for P2Ps, how many are actively in operations in India, the business procedures, lending done through the platforms, role of platforms etc. There is not much available on the websites of these entities either.

We spoke to around 10 P2Ps active in the business and asked certain questions to create a comparatives. The interviews were conducted over the phone and were with the top management of the companies. We also collated data on the secondary information we relied on and from our experience in dealing with P2Ps.

Limitations to the Survey

Some of the P2Ps gave out some very useful insights, however the survey is limited to the 10 P2Ps only. We have relied on telephonic conversations with them on their business models however there was limited information the P2Ps could share due to confidentiality reasons.

Questions to the Survey

The questions pertained to the following:

a. Who are typically the lenders on the platform?

b. Is the system opaque or fairly transparent in dealings to connect peers with peers?

c. What was the mechanism for evaluating the borrowers?

[41] https://p2plendingsite.wordpress.com/2017/06/30/12-benchmarking-p2p-alternative-vs-mainstream-returns/

d. What kind of loans can be availed on the platform?

e. What is the rate of interest charged on these loans?

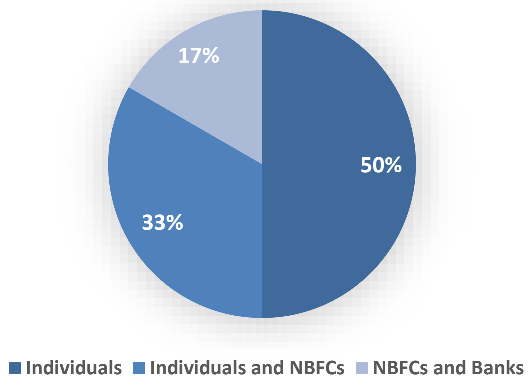
f. How do the platforms earn the revenue?

g. Do the platforms offer any risk coverage?

COLLATING RESULTS TO THE SURVEY

Who are typically the lenders on the platform?

a. Individual
b. Individuals and NBFCs
c. NBFCs and Banks
d. Others



The very essence of P2Ps is that peers lend to peers. However, the survey results and our general finding indicates that lenders on P2P platforms are mostly banks and NBFCs apart from individuals as well.

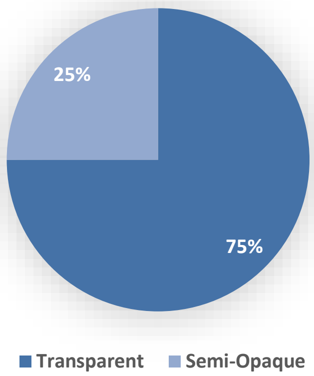
We also discovered that while platforms have several registrations from individuals and other body corporates, active lenders on the platform are only a small proportion of those registered. Among the active lenders, a substantial share is that of NBFCs and Banks.

While it is counter-intuitive that banks and NBFCs would not lend to such borrowers otherwise, however they consider lending to the borrowers through these platforms.

Some banks and NBFCs also view these platforms as a source of finding customers to increase the origination levels. The cost of sourcing business from the platforms is fairly low as compared to other modes of sourcing customers.

Is the system opaque or transparent in dealings to connect peers with peers?

a) Transparent
b) Semi-opaque
c) Opaque



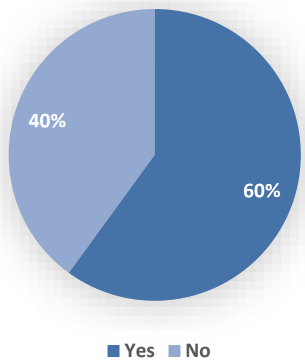
For various reasons and quite obvious ones, we understand that it most favourable for the platforms to create a transparent operating environment for the lenders and the borrowers.

With very little history and confidence on tech-enabled lending-borrowing mechanism, it would be a non-starter for several, if the system was opaque. While some of the countries have a complete opaque model of P2P business, Hong Kong, being one in example, but in India the parties on the platform understand the way business is conducted and have all transparency in flow of funds between parties.

This gives comfort and confidence on the platform not being another Ponzi scheme.

Whether CIBIL Credit Score is required to obtain a loan?

a) Yes
b) No

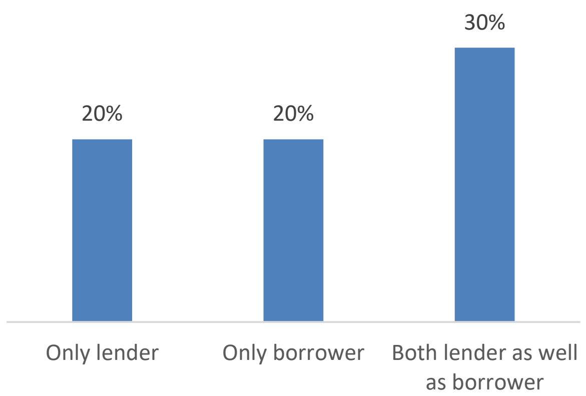


What rate of interest do you charge to the borrowers?

Some borrowers charge in the bracket of 18-20%, while some also charge in the range of 30-50%. "The low-risk borrower will get (an interest rate of) 12-13% while the rate for a high-risk borrower can go up to 25-30%," said Rajat Gandhi, founder and chief executive officer, Faircent.com

Most companies answered that the Human element of the task comes during the stage of system shortfalls. While most of them employ algorithms to

	assess credibility participants, very few employ people to carry out credit assessment.
What is the mechanism for evaluating the borrowers?	*The platforms indicate that the evaluation of the borrower is the sole responsibility of the lenders. The risk of inducing lenders to lend based on sole assessment of the platform is well understood among the platforms.* *The platforms therefore offer basic credit evaluation report based on income levels, CIBIL scores etc.* *The platforms indicated that heavy reliance was placed on the CIBIL score of the prospective borrowers.* *This mechanism in itself has several flaws – 1) borrowers with no past credit history would find it extremely difficult to find prospective lenders on the platform too, 2) P2Ps do not have access to CIBIL scores as the regulations only allow banks or NBFCs to access, update CIBIL scores (this constraint, by the way, has been highlighted several times by the P2P players in doing business), 3) the platforms have to ask borrowers to provide access to their CIBIL scores which also deters borrowers in a way.* *Despite the above issues, lending evaluation by the platform is largely based on CIBIL scores.* *Some P2Ps indicated that they have social media crawlers which add value to the borrower assessment, but we could not gather any details on the way these crawlers extract details.*
What kind of loans can be availed on the platform?	*There is variety on the offering is what we understand. From personal loans, student loans, vocational training loans, unsecured business loans and more.* *There are some P2Ps that are focussed on one kind of loans and there are others who offer bouquet of financial products.*
What is the rate of interest charged on these loans?	*Some borrowers charge in the bracket of 18-20%, while some also charge in the range of 30-50%. "The low-risk borrower will get (an interest rate of) 12-13% while the rate for a high-risk borrower can go up to 25-30%," said Rajat Gandhi, founder and chief executive officer, Faircent.com*

	Most companies answered that the Human element of the task comes during the stage of system shortfalls. While most of them employ algorithms to assess credibility participants, very few employ people to carry out credit assessment.
How do platforms earn the revenue?	*Out of the 10 platforms surveyed by us, 3 of them do not charge any registration fees. This apart, processing fees are charged in the following manner:*  *Again, there did not seem to be any standard approach to this adopted by the P2Ps in India.* *Some did not charge any registration fees for the borrowers, in order to ensure that more and more borrowers registered on the platform.* *Some charged the lenders but effectively loaded it on the borrowers.* *There are others who clearly charged transaction fees from both the borrowers and the lenders. The nomenclature for the charges/ fees charged by the platform differed across platforms.* *The revenue generated by the platform was based on the fees deducted by the platforms in a transaction.* *The key therefore to profitability lied in churning higher volumes on the platform. Greater the number of transactions higher would be the revenue.* *Also the revenue charged was a percentage of the loan amount. This also meant bigger the loans, larger would be revenue earned.* *Some P2Ps also charged registration fees at the time of on-boarding the platform.*

	Like we said, there was no standard coat that fitted all.
Do the platforms offer any risk cover?	*Most of the platforms in India do not have skin-in-the-game to offer. Validly so, since the role is clearly understood to be that of a facilitator. Most P2Ps did not lend themselves on the platform to avoid any sort of conflict of interest.* *However, there were 2 P2Ps, who indicated that they had risk participation offered to the lenders in some proportion of their lending.* *In the U.S. LendingClub also has a risk fund to compensate the lenders upto a level of the loss suffered by them.* *Eventually in India as well, with growing competition in the space, risk participation or skin-in-the-game will make a significant difference.*

Scope for Growth

With the push of the current government for digitalization and technological awareness, it is prudent knowledge that this sector has tremendous potential. The prospective of quick funds for borrowers through a simplified process in itself will act as a boom for this market. The growing number of Small & Medium-sized enterprises (SMEs) and Micro, Small & Medium sized enterprises (MSMEs) in India, reluctance of banks from funding customers with low credit score and poor financial status, government's thrust towards Digitisation (Aadhaar, eKYC, Start-up India) and an environment conducive to the idea of cashless, hassle-free and higher returns on investment are all factors favouring the meteoric rise in P2P business and expected to provide stability to this promising sector.

The major players in this segment have already noticed the bright future prospects in this segment, reporting a growth of around 30-35% monthly, and are making a move to capture the market. Several venture capital and angel investors are on the look out to make investments in companies acting as P2P platform. NBFCs and banks are also aiming to make collaborative partnerships with these platforms. It is also being reported that RBI is considering permitting the P2P players to operate offline as well in a move to fuel the financial growth in the country, incidentally also boosting the growth of P2P ecosystem, especially in rural and semi-urban areas.[42]

Default and Recovery Process

As per data released by India's largest P2P lending platform[43] 87.5 % of the borrowers make payment on time, 6 % of the loans have overdue payments of more than 1 EMIs' but less than 3 EMIs', 4 % of the loans have overdue payments of more than 3 EMIs' but less than 6 EMIs, while only 2.5% of the loan have EMIs' due for a period of more than 6 months.

The RBI has also spelt out in some detail, guidelines and regulations for the recovery process. These are discussed in the relevant section on the RBI Master Directions.

A common practice followed by mostly peer-to-peer lending platforms is as follows:-

1. **Day 1- 15 from date of default**: - The platform sends messages and calls the borrowers reminding him to make the payment. A late payment fees is added to the amount.
2. **Day 16-30 from date of default**: - The platform engages their agency to recover the fund. The recovery agents visit the house of the borrower during this period.
3. **Day 31-120 from date of default**: A third party collection agency is appointed. A higher late payment fee is added. The loan is categorized as a NPA during this period and legal proceedings are initiated. Several credit rating agencies are also informed about the default during this period.

The P2P platforms charge a fee from lenders for undertaking the recovery process if the amount is recovered. The fee is either a percentage of the amount recovered or a predetermined block amount.

Some of the peer-to-peer lending platforms maintain a Lender Protection Fund. This is a reserve created by the platform wherein a portion of the platforms' income is transferred. The fund acts as a security for lenders in case of default by the borrower. The fund only secures the principal amount lent to the borrower. Recently, i2ifunding, one of the big players in the P2P ecosystem in India introduced the concept of 'Principle Protection Fund'[44],

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[42] http://www.thehindubusinessline.com/money-and-banking/p2p-lenders-may-be-allowed-to-operate-offline/article9832335.ece
[43] https://www.faircent.com/sites/default/files/Portfolio_Newsletter_Rev_oct.pdf
[44] http://tech.economictimes.indiatimes.com/news/startups/p2p-lending-firm-i2ifunding-launches-protection-fund-for-retail-investors/53750030

setting aside 5% of the amount of loans disbursed, in order to assure the investor a return at least equal to the principle amount in case of default by the borrower.

This mechanism has both its pros as well as cons - on one hand, it seems a sensible move that is desirable in nature and will protect the investors in case of a mishap; but on the other hand, the Return on Investment (ROI) of investors takes a direct hit as the money has to come from somewhere to facilitate this fund.

Loan Origination Process

The process of registration as a borrower is one of the most critical factors to the success of the platforms, making it essential that the procedure is user-friendly and aesthetically pleasing while at the same time it extracts as much data possible about the prospective borrower. Ensuring that a quality back-end system is in place should be the topmost priorities of any P2P platform given the fact that everything taking place on the medium is virtual in nature. This makes the loan origination process vital and worth mentioning in the given report. The procedure of registration as a borrower is as follows:

1. **Application stage**: Any prospective borrower visiting the platform for the first time will first have to register with the platform. He will have to create an account with the platform, submitting his credit history and other requisite KYC documents along with that. He may also have to link his bank account with the platform for better credit-assessment. This process is also valid for prospective lenders. Both the categories of users have to pay registration fees as well.

   The platforms use the data submitted by the borrowers and make a credit assessment report based on it. In most developed countries, the platforms use computer algorithms to produce this report, emerging countries such as India also add human element in this stage. Most platforms such as Faircent, Prosper, LendingClub use this data to assign borrowers to different interest rate categories. These platforms also specify the minimum and maximum duration for loans. The borrowers also specify the loan amount they are seeking to raise.

2. **Loan Approval**: The loan amount is posted on the platform's website and the prospective lenders may, as per their risk-appetite, select the specified loan amount and the interest it entails and choose to fund it. Almost every P2P platform stipulates that one loan be funded by at least 5 different lenders. This acts as an internal credit enhancement policy and ensures that in case of a default the lender does not lose all his money. Loans raised on P2P platforms must be unsecured in nature (as per the latest RBI Master Directions). The big players in the sector guarantee loans within as little as 10 minutes to a day- this duration varies from platform-to-platform and

country-to-country based on the amount of loan and the purpose for which it is required as well.

3. **Funding**: Once enough lenders submit bids to fund a loan, the money is transferred to the borrower's bank account. This flow must happen via an escrow account. This is discussed in the section on RBI regulations. Thus, regulators now stipulate that money must flow straight to the borrower's account in order to prevent a repeat of the aforementioned example.

Most platforms also do not charge borrowers in case they decide to prepay their loans. In case borrowers fail to repay loans on time, platforms stipulate a percentage that the borrowers will have to pay to the lenders.

Customer Acquisition Channels

Investors aiming for stable and fixed returns flock to P2P platforms. The benefit of diversification provides safety of investment and is one of the reasons why investors are attracted to this avenue of investment. The core-business of the company lies in connecting borrowers and lenders, assuring repayments and credit assessment of the people on its platform. The marketing side of the business is usually not given much importance, one of the main reasons as to why the industry is so under-reaching in many countries. Word of mouth and good performance can only go so far, one has to grab attention. P2P companies usually market themselves through two channels:

1. **Direct Marketing**: One of the most common forms of marketing since the inception of advertising, direct marketing involves making interaction directly with the consumer. Large amounts of data collected during the credit assessment process no doubt provide database for this marketing. LendingClub, for example, regularly mails its customers pre-approved offers and schemes propagating the advantages of higher yields and ancillary services, 50% of which usually result in customer-acquisition.[45] This method of marketing is mostly used by established stalwarts with good marketing analytics and data. One of the aims of this form of marketing should also be to attract a diversified crowd, different from the ones already present on the platform. This will help increase liquidity as a diversified crowd-base will be able to both cater and be catered by a group of people with different wants and needs.

2. **Strategic Alliances**: Some of the established platforms form partnerships with banks and fund loans, share consumer data, and partner to create credit products. Some banks even purchase loans lent on P2P platforms and vice-a-versa. In some countries like Australia this has become a regulatory requirement as well. The partnership between Santander and Funding Circle is an example of this strategy, with both the companies

[45] http://www.ey.com/Publication/vwLUAssets/ey-understanding-alternative-lending/$File/ey-understanding-alternative-lending.pdf

reaping benefits from the deal.[46] This form of advertising-cum-financing help drive growth of most P2P platforms and this has also led to them being seen as complementary to banks rather than competitors. This will also help expand the market share of the P2P companies to far wider areas.

Current Market Scenario

The P2P regulations issued by RBI has shrunk the India's P2P lending industry. Currently there are only 19 P2P platforms registered with RBI as per the data released by RBI on July 31,2019[47]. However, the number of P2P lenders registered with RBI is lower than the number of entities that were operating in this segment before issuance of the regulations. This is because the regulator has imposed stringent conditions on the companies undertaking the business of peer-to-peer lending platform.

One such condition that has weeded out small players is the requirement of having net owned funds of Rs. 2 crores. Further, the cap on the exposure of the lender and aggregate loans taken by the borrower at any time is of Rs. 10 lakhs. This is expected to become a hindrance in the development of the industry.

P2P platforms are in infant stage in India. Faircent was the first P2P platform registered in India. Since, its inception in 2018, it has facilitated lending of around Rs. 169.12 lakhs with an average interest rate being 24.85%.

The country as whole has seen lending of around Rs. 211.4 lakhs until now.

The P2P lenders are required to create and manage two escrow accounts, one for disbursal of funds by lenders and other for the money repayments from borrowers. A bank-promoted trustee is required to be appointed for monitoring the escrow accounts. These provisions are inconvenient and increases the cost of operations while the profit margins remains low.

The registered P2P lenders have access to data from credit bureaus, which help them expand the pool of potential borrowers which fall within the risk profile that lenders are looking for.

The regulations of RBI have introduced a structure for the unregulated P2P market and is a step towards levelling the field for all financial institutions. Further, it is expected that more companies will undertake the business of P2P lending and shall get themselves registered with RBI.

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[46] https://www.euromoney.com/article/b12kpntgmmgd31/bank-collaboration-with-p2p-platforms-rising

[47] http://rbidocs.rbi.org.in/rdocs/content/DOCs/P2P30062018.xlsx

ISSUES IN P2P LENDING

Marketplace lending: Legal issues around "true lender" and "valid when made" doctrines

With marketplace lending showing signs of tremendous growth, experience and time seem to be giving rise to certain interesting legal issues. The issues seem to be emanating from the fact that P2P platforms essentially do pairing of borrowers and lenders. In the US practice, it is also commonplace to find an intermediary bank that houses the loans for a few days, before the loan is taken up by the "peer" or crowd-sourced lender.

USA, like many other countries, has usury laws. However, usury laws are not applicable in case of banks. This comes from sec 85 of National Bank Act, and sec. 27 (a) of the Federal Deposit Insurance Act.

In P2P structure, the loan on the platform may first have been originated by a bank, and then assigned to the buyer. If the loan carries an interest rate, which is substantially high, and such high interest rate loan is taken by the "peer lender", will it be in breach of the usury laws, assuming the rate of interest is excessive?

One of the examples of recent legal issues in this regard is *Rent-Rite Superkegs West, Ltd., v. World Business Lenders*, LLC, 2019 WL 2179688[48]. In this case, a loan of $ 50000 was made to a corporation by a local bank, at an interest rate of 120.86% pa. The loan-note was subsequently assigned to a finance company. Upon bankruptcy of the borrower, the bankruptcy court refused to declare the loan as usurious, based on a time-tested doctrine that has been prevailing in US courts over the years – called valid-when-granted doctrine.

Valid-when-granted doctrine

The valid-when-granted doctrine holds that if a loan is valid when it is originally granted, it cannot become invalid because of subsequent assignment. Several rulings in the past have supported this doctrine: e.g., *Munn v. Comm'n Co*., 15 Johns. 44, 55 (N.Y. Sup. Ct. 1818); *Tuttle v. Clark*, 4 Conn. 153, 157 (1822); *Knights v. Putnam*, 20 Mass. (3 Pick.) 184, 185 (1825)

However, there is a ruling that stands out, which is 2015 ruling of the Second Circuit court in *Madden v. Midland Funding, LLC* (786 F.3d 246). In *Madden*, there was an assignment of a credit card debt to a non-banking entity, who charged interest higher than permitted by state law. The court held that the

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48 https://www.docketbird.com/court-documents/Rent-Rite-Super-Kegs-West-LTD-v-World-Business-Lenders-LLC/Corrected-Written-Opinion-related-document-s-44-Written-Opinion-48-Order-Dismissing-Adversary-Proceeding/cob-1:2018-ap-01099-00049

relaxation from interest rate restrictions applicable to the originating bank could not be claimed by the non-banking assignee.

The ruling in *Madden* was deployed in a recent [June 2019] class action suit against JP Morgan Chase/Capital One entities, where the plaintiffs, representing credit card holders, allege that buyers of the credit card receivables (under credit card receivables securitization) cannot charge interest higher than permitted in case of non-banking entities. Plaintiffs have relied upon the "true sale" nature of the transaction, and contend that once the receivables are sold, it is the assignee who needs to be answerable to the restrictions on rate of interest.

While these recent suits pose new challenges to consumer loan securitization as well as marketplace lending, it is felt that much depends on the entity that may be regarded as "true lender". True lender is that the entity that took the position of predominant economic interest in the loan at the time of origination. Consider, however, the following situations:

a. In a marketplace lending structure, a bank is providing a warehousing facility. The platform disburses the loan first from the bank's facility, but soon goes to distribute the loan to the peer lenders. The bank exits as soon as the loan is taken by the peer lenders. Will it be possible to argue that the loan should be eligible for usurious loan carve-out applicable to a bank?
b. Similarly, assume there is a co-lending structure, where a bank takes a portion of the loan, but a predominant portion is taken by a non-banking lender. Can the co-lenders contend to be out of the purview of interest rate limitations?
c. Assume that a bank originates the loan, and by design, immediately after origination, assigns the loan to a non-banking entity. The assignee gets a fixed, reasonable rate of return, while the spread with the assignee's return and the actual high interest rate paid by the borrower is swept by the originating bank.

Identity of the true lender becomes an intrigue in cases like this.

Securitization transactions stand on a different footing as compared to P2P programs. In case of securitization, the loan is originated with no explicit understanding that it will be securitized. There are customary seasoning and holding requirements when the loan is incubated on the balance sheet of the originator. At the time of securitization, whether the loan will get included in the securitization pool depends on whether the loan qualifies to be securitized, based on the selection criteria.

However, in case of most P2P programs, the intent of the platform is evidently to distribute the loan to peer-lenders. The facility from the bank is, at best, a bridging facility, to make it convenient for the platform to complete the disbursement without having to wait for the peer-lenders to take the portions of the loan.

US regulators are trying to nip the controversy, by a rule that Interest on a loan that is permissible under 12 U.S.C. 85 shall not be affected by the sale, assignment, or other transfer of the loan. This is coming from a proposed rule by FDIC /OCC in November, 2019[49].

However, the concerns about the true lender may still continue to engage judicial attention.

Usurious lending laws in other countries

Usurious lending, also known as extortionate credit, is recognised by responsible lending laws as well as insolvency/bankruptcy laws. In the context of consumer protection laws, usurious loans are not regarded as enforceable. In case of insolvency/bankruptcy, the insolvency professional has the right to seek avoidance of a usurious or extortionate credit transaction.

In either case, there are typically carve-outs for regulated financial sector entities. The underlying rationale is that the fairness of lending contracts may be ensured by respective financial sector regulator, who may be imposing fair lending standards, disclosure of true rate of interest, etc. Therefore, judicial intervention may not be required in such cases. However, the issue once again would be – is it justifiable that the carve-out available to regulated financial entities should be available to a P2P lender, where it is predesigned that the loan will get transferred out of the books of the originating financial sector entity?

Conclusion

P2P lending or fintech credit is the fastest growing part of non-banking financial intermediation, sometimes known as shadow banking. A lot of regulatory framework is designed keeping a tightly-regulated bank in mind. However, P2P is itself a case of moving out of banking regulation. Banking laws and regulations cannot be supplanted and applied in case of P2P lending.

[49] https://www.occ.gov/news-issuances/news-releases/2019/nr-occ-2019-132a.pdf

FINTECH CREDIT: A DISRUPTION IN SHADOW BANKING SPACE

One of the notable areas of development in NBFI space has been the evolution of FinTech credit. The term FinTech credit may be used to denote various business models [50]. The most common variant is P2P lending platforms, which are in the business of connecting the borrowers with investors making use of technology platforms, with or without the pooling of funds with the platform till the requisite money for the borrower's needs has been crowd-sourced. A report of Working Group of CGFS-FSB on FinTech Credit defines it as follows: "FinTech credit" encompasses all credit activity facilitated by electronic platforms whereby borrowers are matched directly with lenders. These entities are commonly referred to as "loan-based crowdfunders", "peer-to-peer (P2P) lenders" or "marketplace lenders".[51] It encompasses all credit activity facilitated by platforms that match borrowers with lenders (investors). It also includes platforms that use their own balance sheet to intermediate borrowers and lenders. In principle, the credit activity of platforms provided by technology companies can also be included."[52]

The global Fintech industry was valued at about $ 127.66 end-2018, and is expected to grow at a CAGR of 24.8% p.a. to reach about $ 310 billion by 2022[53].

Relative size of Fintech is quite significant in several countries such as US (where FinTech credit in 2016 amounted to USD 32.4 billion), UK (where FinTech credit in 2016 amounted to USD 6.1 billion) and China (where FinTech credit in 2016 amounted to USD 240.9 billion). Additionally, the ratio of P2P loans to bank loans in China rose to almost 40%, before falling to about 10% in 2018

PRINCIPLES GUIDING REGULATORY FRAMEWORKS

The regulatory frameworks governing FinTech credit in various economies are guided by one common principle, which is "neutrality". This implies ensuring that regulation does not favour one entity or form of activity over another

[50] FinTech credit, as used in this Chapter, is a subset of a wider term, often called "alternative finance", which includes FinTech credit, equity crowdfunding, and cryptocurrency offerings.

[51] https://www.fsb.org/wp-content/uploads/CGFS-FSB-Report-on-FinTech-Credit.pdf

[52] https://www.bis.org/publ/qtrpdf/r_qt1809e.htm

[53] https://www.thebusinessresearchcompany.com/report/fintech-global-market-report

Bali Fintech Agenda

In October, 2018, IMF and World Bank launched Bali Fintech Agenda, a set of 12 policy elements aimed at helping member countries to harness the benefits and opportunities of rapid advances in financial technology that are transforming the provision of banking services, while at the same time managing the inherent risks. The 12 elements are:

I. Embrace the Promise of Fintech
II. Enable New Technologies to Enhance Financial Service Provision
III. Reinforce Competition and Commitment to Open, Free, and Contestable Markets
IV. Foster Fintech to Promote Financial Inclusion and Develop Financial Markets
V. Monitor Developments Closely to Deepen Understanding of Evolving Financial Systems
VI. Adapt Regulatory Framework and Supervisory Practices for Orderly Development and Stability of the Financial System
VII. Safeguard the Integrity of Financial Systems
VIII. Modernize Legal Frameworks to Provide an Enabling Legal Landscape
IX. Ensure the Stability of Domestic Monetary and Financial Systems
X. Develop Robust Financial and Data Infrastructure to Sustain Fintech Benefits
XI. Encourage International Cooperation and Information-Sharing
XII. Enhance Collective Surveillance of the International Monetary and Financial System

provided the risks are the same. Essentially, activities with higher risk are certainly regulated by stricter provisions and those with lower risks are, liberally.

Various countries have different norms for regulating fintech credit activities. For example, in Australia and the Netherlands, fintech credit providers must apply for a specific licence (and meet the associated stricter requirements) to facilitate credit to consumers. In the US, platforms engaging in credit origination can be subject to licensing requirements in each state where they operate. In Germany platforms are prohibited from engaging in lending without a banking licence and related prudential oversight. Minimum capital requirements have been imposed in Spain and the United Kingdom.

Regulators, especially in developing economies, have been liberal in their approach towards innovation and allowing market entry. Protecting the market and simultaneously promoting innovation is a tricky venture and introduction of concepts like "Regulatory Sandbox" takes care of achieving a balance.

The following table represents features of regulatory frameworks for fintech credit providers in various jurisdictions:

Selected features of dedicated fintech credit policy frameworks					
Jurisdiction	**Tax incentives**	**Regulations**	**Licensing / authorisation**	**Investor protections**	**Risk management requirements[54]**
Australia	-	-	-	-	-
Brazil	-	Yes	Yes	Yes	-

[54] Specific rules for fintech credit that are separate from pre-existing rules for other financial intermediaries.

Canada	-	-	-	-	-
Chile	-	-	-	-	-
China	Yes	Yes	Yes	Yes	Yes
Estonia	-	-	-	Yes	-
Finland	-	Yes	Yes	-	-
France	Yes	Yes	Yes	Yes	Yes
Germany	-	-	-	-	-
Japan	Yes	-	-	-	-
Korea	-	-	-	-	-
Mexico	-	Yes	Yes	-	Yes
Netherlands	-	-	-	Yes	-
New Zealand	-	Yes	Yes	-	Yes
Singapore	-	-	-	-	-
Spain	-	Yes	Yes	-	Yes
Switzerland[55]	-	Yes	Yes	Yes	Yes
United Kingdom	Yes	Yes	Yes	Yes	Yes
United States	-	-	-	-	-

CYCLICALITY OF P2P LENDING

Fintech credit provision could also be more procyclical than traditional credit. Compared with bank deposits, fintech investments can be more prone to investors' search for yield, as seen for some platforms in the recent upswing. An undiversified business model and lack of access to public safety nets make fintech credit more vulnerable to investor pullback, and thus to sharp contractions in times of stress. In addition, more credit activity outside the prudential regulatory net could limit the effectiveness of credit-related countercyclical macroprudential meares[56]

RISKS OF FINTECH LENDING

“Among the risks are a potential deterioration of lending standards, increased procyclicality of credit provision, and a disorderly impact on traditional banks, for example through revenue erosion or additional risk-taking. FinTech credit also may pose challenges for regulators in relation to the regulatory perimeter and monitoring of credit activity”.[57]

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[55] New rules effective from 2019. Sources: CGFS-FSB (2017); national authorities

[56] https://www.bis.org/publ/qtrpdf/r_qt1809e.htm

[57] https://www.fsb.org/wp-content/uploads/CGFS-FSB-Report-on-FinTech-Credit.pdf

SECURITISATION OF MARKETPLACE LENDING

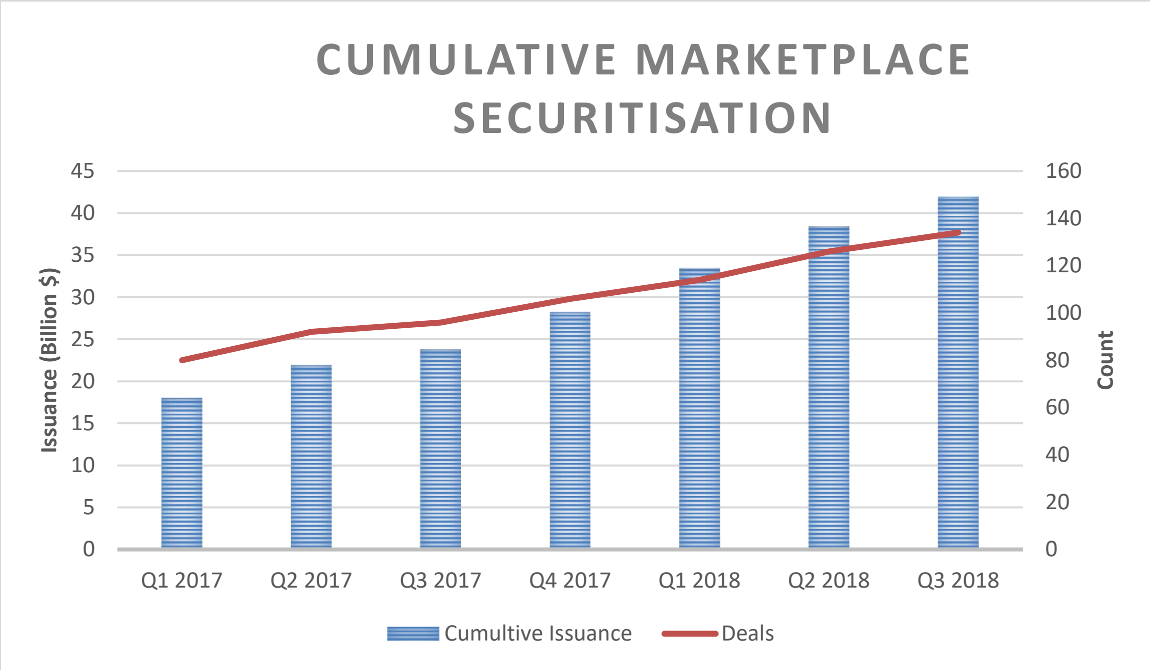
Marketplace lending, formerly known as “peer-to-peer” loans, is entering a new phase of growth as fintech lenders have started packaging their loans into securitized financial products that could attract major investment from institutions. Over the past decade, marketplace lending has established itself as more than a niche industry for consumers and small businesses. These loans are facilitated by marketplace lending platforms like LendingClub, Prosper etc. These platforms use sophisticated technology tools to connect borrowers to a diverse array of lenders and provide advanced credit reporting and analytics. This growth has attracted the attention of institutional investors who have seen the loans as a source of higher yield and diversification in an era of low interest rates. However, several obstacles have prevented institutions from moving into the asset class. Chief among them are the sector’s lack of performance history, minimal levels of liquidity, a lack of credit ratings on some loans, and internal investment guidelines that restrict many institutions from purchasing assets that are not securities.

The emergence of securitisation in this industry, solves many of the aforesaid problems. The first marketplace loans were securitized in USA in September 2013, and the trend has accelerated rapidly since then. In 2017, it is estimated that $14 billion[58] of U.S. marketplace loans were securitized, which is on the order of one third of all such loans originated in the U.S. that year.

The third quarter of 2018 saw 8 securitization deals totalling $3.46 Billion in new issuance, the fifth-highest quarterly issuance in the history Marketplace Lending in USA. The total issuance volume represents a 35% increase YoY over the total volume issued in Q3 of 2017.Total securitization issuance now stands at $41.9 billion, with 134 deals issued to date. Overall issuance has been the fifth-highest ever in Q3 of 2018. Total Marketplace Lending issuance in Q3 was $3.5 billion. Goldman Sachs continues to lead the deal flow in 2018 with $2.8 billion in issuance, followed by Citigroup at $2.6 billion. The top three dealers

[58] https://www.morganstanley.com/im/publication/insights/investment-insights/ii_anintroductiontoalternativelending.pdf

Citigroup, Deutsche Bank and Credit Suisse have 57% of the total market share in the Marketplace Lending space since 2013[59].



Source: PeerIQ

The above chart depicts the cumulative marketplace securitisation in the USA and the same is expected to grow in future.

[59] https://www.peeriq.com/research/lending-earnings-insights-2018-q4/

CONCLUSION

The recently introduced regulations are playing a hand in formally recognizing this industry.

The Regulator has, perhaps, erred on the side of caution, much like the instinct of regulatory bodies around the world. The guidelines are certainly on the strict side. To be sure, there will be modifications and further clarifications added to these regulations; and they will play a large part in allowing for controlled and regulated expansion of the market.

As technology changes the ways in which we interact and transact, P2P lending is certainly a novel method which cuts the need for financial intermediation by banks and financial institutions. While our algorithms evolve to be able to accurately capture risks of default, the discretionary touch of human intervention will be important in markets as nascent as in India. While this is certainly a controlled growth phase in the market, all eyes will be on this market to see if it can evolve to become the next big disruption in the financial services industry.

ANNEXURE I: FAQS ON RBI REGULATIONS ON P2P LENDING PLATFORM

1. What is meant by a platform?

Platform means some kind of a device which connects the participants.

2. What is the definition of Peer-to-Peer lending platform?

As per Para 4(1)(v) of the directions, “Peer to Peer lending platform” means an intermediary providing the services of loan facilitation via online medium or otherwise to the participants as defined at Item (iv) of sub-paragraph (1) of paragraph 4 of these directions.

3. Who is a Participant?

As per the Para 4(1)(iv) of the directions, “Participant” means a person who has entered into an arrangement with an NBFC-P2P to lend on it or to avail of loan facilitation services provided by it.

4. What are the conditions for being classified as a ‘P2P Lending Platform’ under the RBI Directions?

As per RBI directions, “Peer to Peer Lending Platform” means an intermediary providing the services of loan facilitation via online medium or otherwise, to a person who has entered into an arrangement with an NBFC-P2P to lend on it or to avail of loan facilitation services provided by it.

Accordingly, it can be inferred that a P2P Lending Platform must act as an intermediary between the participants. Secondly, as the definition states- ‘online or otherwise’- this clearly means that any platform, whether operating on online platform or offline, is required to adhere to the NBFC-P2P directions. Additionally, participants must enter into an arrangement with the P2P Lending Platform. This means in order to operate any P2P Lending Platform, lenders as well as borrowers need to be registered with the platform.

5. Will any intermediary connecting participants be considered as a platform?

Here, platform implies impersonal platform. If platform means a personalized service then every loan-broker, every Direct Selling Agent (DSA) would be carrying out P2P activity, which is not the intent of the law. The intention is to describe platform as an arrangement that is impersonalized in nature, with the sole intent being to connect lenders and borrowers.

Further, the definition of platform hinges on the magnitude of transparency. As per the RBI Directions, only one-way transparency exists, such that the lender is aware of the borrower's personal identity, required amount, interest rate sought and credit score as arrived by the NBFC-P2P, but the borrower is only aware of details about the lender's proposed amount, interest rate offered but excluding personal identity and contact details.

Thus, any platform that connects various lenders and borrowers but fails to maintain this one-way transparency will not be able to comply with the RBI Directions and hence, it must not be considered as a P2P Lending Platform.

For example, if someone opens a café with the intent of connecting lenders and borrowers, it will not be constituted as a P2P platform merely for the fact that they are connecting lenders and borrowers. Since it is virtually impossible to maintain one-way transparency in such a setup, the basic intent of the regulations will defeated. However, in the near future if it does becomes viable to open an offline platform in such a manner that it succeeds in maintaining one-way transparency, it may be constituted as a P2P Lending Platform and hence the RBI Directions would become applicable.

6. What is meant by loan facilitation?

It means connecting lenders and borrowers as well as carrying out the credit assessment and risk profiling of the participants on the platform.

7. Whether an intermediary originating loans exclusively for a lender be considered as a P2P Lending Platform?

Since the exclusivity criteria violates the very essence of a P2P lending platform, i.e. connecting unrelated peers on its platform, hence it will not be regarded as a P2P Lending Platform.

8. Will a direct selling agent originating loans online or offline for an NBFC/Bank be considered a P2P platform?

Same as above.

9. Whether a lender floating an exclusive platform for the purpose of disbursing loans constitutes to be a P2P platform?

This kind of setup would lead to the existence of an individual lender and it would also reveal the identity of the lender. So, it would clearly violate the transparency criterion and hence, would not be considered to be a P2P lending platform.

10. What type of loans can be disbursed through the platform?

Only unsecured loans can be extended on the platform. Further, the platform cannot cross sell any product except for loan specific insurance products. There exists a restriction on the P2P Lending Platforms to provide or arrange any credit enhancement or credit guarantee, discouraging the P2P players from creating innovative products like principal protection to safeguard lender's money.

11. Does a loan taken by a corporate borrower be classified as a deposit?

For the borrower, the platform is the face from whom the loan is being originated. Now, given the fact that the platform itself is an NBFC-P2P, there exists no breach of regulations. Since the borrower is unaware of the personal details of the person who is actually lending, the funding cannot be classified as deposit. Hence, in our view, loan taken by a company will not classify as a deposit since there exists one-way opacity.

12. What is the definition of NBFC-P2P?

As per Para 4(1)(vi) of the directions, NBFC-P2P means a non-banking financial institution which carries on the business of a Peer to Peer Lending platform

13. What are the eligibility criteria for registration as a NBFC-P2P?

The directions specify the following eligibility criteria to be registered as an NBFC-P2P:

- Only a NBFC may carry out the business of P2P lending.
- Any NBFC whether looking to commence or already operating as a P2P lending platform must obtain a Certificate of Registration (CoR) from RBI.
- An NBFC-P2P must have a net owned fund of not less than Rs. 2 crores in order to seek registration with the RBI.

14. What is the process of registration of a P2P Lending Platform?

As per RBI's Directions, all existing and prospective NBFC-P2Ps will be required to submit an application for registration to the Department of Non-Banking Regulation, Mumbai.

15. What is the process of registration for prospective P2P lending platforms?

For new entities, the RBI shall grant an in-principle approval for setting up and operating a P2P Lending Platform, after being satisfied that all the conditions are fulfilled.

16. What is the validity of the approval?

The validity of the in-principle approval issued by RBI will be twelve months from the date of granting such in-principle approval.

17. What are the activities that the prospective P2P lending platform needs to perform during these 12 months?

Within the period of twelve months, the company will be required to develop the technology platform as well as submit all other legal documentations.

18. Is it mandatory for a company to wait for a gestation period of one year before registration with RBI?

A new entity after submitting the application is provided a period of twelve months for setting up and operating a P2P Lending Platform. The period of twelve months is only for the validity of the in-principal approval of the RBI, it is not a mandatory waiting period for the entity. As soon as the set-up is ready they shall approach the RBI and report the position of compliance with the terms of in-principle approval and the RBI, after being satisfied that the entity is ready to commence operations, grant the registration.

19. What is the process of registration for existing P2P lending platforms?

Existing companies must apply for registration as an NBFC-P2P with RBI within 3 months from the date of effect of the directions, i.e. 4^{th} October, 2017.

20. Can the existing companies continue business until the approval has been granted?

Yes, the existing companies are free to continue operating as a P2P lending platform till their certificate for issuance of CoR has been rejected.

21. When can RBI revoke the CoR granted to NBFC-P2Ps?

The RBI may cancel the CoR if the company-

a. ceases to carry on the business of Peer to Peer Lending Platform in India; or
b. has failed to comply with any condition subject to which the CoR has been issued to it; or
c. is no longer eligible to hold the CoR; or
d. fails to –
(i) comply with any Direction issued by the Bank; or
(ii) maintain accounts, publish and disclose its financial position in accordance with the requirements of any law or any Direction or order issued by the Bank; or
(iii) submit or offer for inspection its books of account or other relevant documents when so demanded by the Bank.

22. What happens to the existing transaction on the platform in case of revocation of the CoR?

An NBFC-P2P, shall be permitted to continue the business of a P2P Lending Platform till their application for issuance of CoR is rejected. The RBI shall consequently impose such conditions on the operations of the platform to ensure the winding down of its existing business. Further, NBFC-P2P should have a Board approved Business Continuity Plan in place for safekeeping of information and documents and servicing of loans for full tenure in case of closure of platform.

23. Is there any qualifying criteria specified for registration as a lender on the P2P Lending Platform?

The lender can either be an individual or a legal person requiring a loan. While the RBI directions do not mention any specific criteria for qualification as a participant, they do state that the platforms themselves must put in place a board approved policy setting out the eligibility criteria for the participants.

24. Is there any qualifying criteria specified for registration as a borrower on the P2P Lending Platform?

The same qualifying criteria applies to borrowers as for lenders.

25. Can anyone register as a lender on the platform?

Any legal person is eligible to register as a lender on the platform given they fulfill the criteria required by the concerned platform's policy. That is to say that various P2P lending platforms will have their own board approved policy in place specifying conditions for the eligibility of participants on the platform. There are no criteria specified by RBI relating to eligibility of participants. However, it must be ensured that there is no international flow of funds and the participant adheres to legal requirements under applicable laws.

26. Can anyone register as a borrower on the platform?

Same as above.

27. What is Leverage Ratio?

Para 4(1)(ii) of the RBI directions define Leverage Ratio as Total Outside Liabilities divided by Net Owned Funds.

28. What is the Leverage Ratio threshold to be maintained by an NBFC-P2P?

Para 7(1) of the RBI directions specify that the Leverage Ratio of a NBFC-P2P should not exceed 2.

29. Are there any limits on lending through the platform as per the directions?

The RBI directions, under sub-parts 2 and 4 of its Prudential Norms, state that a lender cannot lend more than Rs. 50 lacs to all borrowers across all platforms. Further, he cannot lend more than Rs. 50,000 to a single borrower across all platforms.

30. Are there any limits on borrowings through the platform as per the directions?

The RBI directions, under sub-parts 3 of its Prudential Norms, state that a borrower cannot avail more than Rs. 10 lacs as loan across all platforms. Further, he cannot borrow more than Rs. 50,000 from a single lender across all platforms.

31. Is there any limit to the tenure of loans granted on P2P Lending Platforms?

The RBI directions, under sub-part 5 of its Prudential Norms state that the maturity of loans shall not exceed 36 months.

32. Do the Directions provide any operations guidelines for the platform?

i. An NBFC-P2P must have a board approved policy in place describing the:
   a. Eligibility criteria for participants on its platform;
   b. Pricing of services provided by it;
   c. Rules for matching lenders with borrowers in an equitable and non-discriminatory manner.

ii. The platform itself will be held liable for the activities outsourced by it and for the actions for service providers including recovery agents.

iii. The platform shall be responsible for the confidentiality of information pertaining to participants that is available with the service providers.

iv. As per Fair Practices Code, the platform shall display a caveat that *"Reserve Bank of India does not accept any responsibility for the correctness of any of the statements or representations made or opinions expressed by the NBFC-P2P, and does not provide any assurance for repayment of the loans lent on it".*

33. Is there any obligation on part of the participants?

The participants and the NBFC-P2P must enter into appropriate arrangement that should categorically specify all the terms and conditions among the borrower, the lender and the NBFC-P2P. Also, the agreement must contain necessary consents from the participants for disclosing the required credit information.

Further, P2Ps cannot disburse loans unless individual lenders approve the individual borrowers and the concerned participants have signed the loan contract. However, clarification is required on how the execution of agreements between borrowers and lenders will take place, as the lender's personal identity is not to be revealed to the borrower.

As per the Fair Practice Code, the NBFC-P2P must obtain explicit affirmation from the lender stating that he/ she has understood the risks associated with the proposed transaction and that there is no guarantee of return and that there exists a likelihood of loss of entire principal in case of default by a borrower and that the platform shall not provide any assurance for the recovery of loans.

34. How will the transparency be maintained between the participants?

An NBFC-P2P shall disclose to the lender, details about the borrower/s including personal identity, required amount, interest rate sought and credit score as arrived by the NBFC-P2P. Also, details about all the terms and conditions of the loan, including likely return, fees and taxes shall be disclosed to the lender. However, the borrower will be able to view only details such as proposed amount, interest rate offered but not the personal identity and contact details of the lender.

35. Does the lender know the personal identity of the co-lenders that are funding the same loan?

The lender only knows the borrower but the identity of the co-lenders remains concealed. There is no specific requirement for disclosure of identity of the co-lenders.

36. Is it the role of the platform to select a lender for a particular borrower to fulfill a loan transaction?

The platform does not play any part in selecting lenders for a loan transaction. If it does so, it does not qualify as a P2P Lending Platform because the platform must offer unbiased choice to the lenders and it should not be involved in the selection process of participants in a loan transaction.

The platform simply provides a framework that assembles the lender and borrower in a common place. The lender selects the borrower based on specific requirements for the proposed loan transaction.

37. Between whom will the loan agreement be executed?

The language of RBI directions state that 'No loan shall be disbursed unless the individual lender/s have approved the individual recipient/s of the loan and all concerned participants have signed the loan contract.' There is lack of clarity on how the execution of agreements between borrowers and lenders will take place, given that the lender's personal identity is not to be revealed to the borrower.

In our view there will exist a system of one-way consent, such that there exists an online contract between the lender and the borrower through the platform. Each lenders may be given a separate identity code and the borrower is made aware of the lending details by referring to this code, in a way hiding his identity and contact details. For example, borrower requests for a certain amount of loan, with an option to avail the funding from a set of lenders The click-wrap agreement that the borrower signs should specify that they are agreeing to avail the funding facility and shall comply with the other terms and conditions of the facility and once one or more matching lenders agree to fund a loan, the lender also signs an 'I

Agree' contract to extend the facility. The platform shall act as a conduit between the parties executing the contract to maintain the one-way transparency.

38. When will the lender deposit the loan amount?

Ideally, the lender shall deposit the amount at the time of registration or on-boarding itself. This will prevent any delay in case the platform matches participants and also eliminate the chances of a last-minute failure where the platform has to go hunting for funds and fails to procure the same.

39. How will the interest rate be decided?

As per the RBI Directions, the lender will be aware of the borrower's personal identity, required amount, interest rate sought and credit score as arrived by the NBFC-P2P.

This implies that the borrower, upon registration or as and when he required funding, will disclose the loan amount he needs and the maximum interest rate that he is willing to accept.

Further, from the lender's perspective, the platform may conduct an auction, sorting interest rate bid by the prospective lenders in an ascending order and finally selecting the lenders on the basis of the ones seeking the nearest rate, equal to or more than the borrower's desired rate of interest.

Also, the lender may insert a caveat in the application form explaining the nature of his risk, which may specify whether he wishes to lend at an interest rate lower/more than his preference or not.

40. How will the transfer of funds take place?

Para 9 of the RBI Directions state that funds transfer between the participants and the platform must take place through escrow accounts mechanism, which will be operated by a trustee. The platform must maintain at least 2 escrow accounts- one for funds received from lenders and awaiting disbursal, while the other for maintaining collections from borrowers.

41. Who appoints the trustee?

The trustee must be appointed by the bank maintaining the escrow accounts.

42. What is the role of the trustee in the funds transfer mechanism?

The trustee shall be giving instructions to the bank and directly handle the operations of the escrow accounts based on the instructions received from the lender and the borrower or the platform on behalf of them.

43. Are both cash and bank transactions permitted for funds transfer?

Para 9 of the directions clearly state that only bank transfers are allowed and that cash transactions are strictly prohibited.

44. How will the flow of information take place for the funds transfer mechanism?

While there is no clarity on information exchange, it can be devised based on the mechanism advised by RBI in the Directions. Accordingly, the platform may give direct instructions on behalf of the lender and the borrower to the trustee. There can also be a two level confirmation, one from the platform and the other from the respective lender or borrower concerned with a particular loan transaction.

45. Do the regulations impose any obligation for submission of credit information?

Para 9 of the directions state that all NBFC-P2Ps must become members of all Credit Information Companies (CICs) and submit current as well as historical data to them. Further, the company itself must maintain and keep updated the credit information relating to borrower transaction on its platform.

46. Is there any interval for update of credit data with the platform?

The directions stipulate that the NBFC-P2P must update the credit data regularly on a monthly basis or at such shorter intervals as may be mutually agreed between the NBFC-P2Ps and the CICs. It must also take necessary steps to ensure that this information is relevant, accurate and complete in nature.

47. Are there any public disclosures that the platform is required to make?

Sub-part 1(iii) of the Transparency and Disclosure Requirements of the directions state that the platform must publicly disclose on its website:

a. overview of credit assessment/score methodology and factors considered;
b. disclosures on usage/protection of data;
c. grievance redressal mechanism;
d. portfolio performance including share of non-performing assets on a monthly basis and segregation by age; and

e. its broad business model.

48. How will NPAs be classified by a NBFC-P2P?

The RBI directions define Non-Performing Asset as a *“loan where interest and/or installment of principal remain overdue for a period of 90 days or more”,* though there is no relevance of such definition here for the NBFC-P2P.

49. How frequently does the platform have to update its NPAs?

Para 11(1)(iii)(d) of the directions state that its portfolio performance including share of NPAs must be updated on a monthly basis.

50. In what format will the interest rate charged by the platform be displayed?

Para 11(3) of the directions state that the interest rate must be stated in Annualized Percentage Rate (APR) format.

51. What are the Fair Practices Code guidelines as per the Directions?

The directions state that a board approved FPC must be put in place and uploaded on its website as well. This code must be designed keeping in mind the guidelines mentioned in the Direction. The Board of Directors must also provide for periodic review of the compliance of the FPC and the functioning of grievance redressal mechanism at various levels of management. Further, a consolidated report outlining the reviews shall be submitted to the Board at regular intervals, as may be prescribed by it.
More importantly, the NBFC-P2P must make sure that any information relating to the participants received by it is not disclosed to any third party without the consent of the participants.

52. What grievance redressal mechanism has been prescribed by the directions?

Para 13 of the directions state that the NBFC-P2P must put in place a board approved grievance redressal policy and must also display the following information clearly on its website:

(i) the name and contact details (Telephone / Mobile Nos. as also email address) of the Grievance Redressal Officer who can be approached for resolution of complaints against the NBFC-P2P.

(ii) that if the complaint / dispute is not redressed within a period of one month, the participant may appeal to the Customer Education and Protection Department of the Bank.

53. Within what time-frame should the complaints be dealt with?

The directions specify that the complaints must be handled/ disposed of by the NBFC-P2P within such time and manner as mentioned in the board approved policy, but in any case not more than a period of one month from the date of receipt of complaint must be taken.

54. What is the IT framework guideline specified by the directions?

RBI, recognizing the fact that a dependable IT framework is essential for smooth and efficient P2P lending industry, has stated in Para 14 of the directions that the NBFC-P2P would be required to confirm with the IT framework for the NBFC sector[60] and has also separately stated that the technology should be scalable to handle growth in business. Further, sub-part 2 of the Para clearly specifies that adequate safeguards must be built in the system to ensure that it is protected against unauthorized access, alteration, destruction, disclosure or dissemination of records and data. The RBI may, in case it deems fir, also prescribe technical specifications from time to time.

55. What do the directions state with regards to audit of IT framework of the platforms?

Para 14(4) of the directions specify that an Information System Audit should be in place and must be conducted at least once in two years by CISA certified external auditors. Report of the external auditor shall be submitted to the Regional Office of the Department of Non-Banking Supervision of the Bank, under whose jurisdiction the Registered Office of the NBFC-P2P is located, within one month of submission of the report by the external auditor.

56. What do the directions state with regard to Business Continuity Plan for NBFC-P2Ps?

Para 14(3) of the directions specify that a NBFC-P2P must have a board approved Business Continuity Plan in place for safe-keeping of information and documents and servicing of loans for full tenure in case of closure of platforms.

57. What is the Fit and Proper criteria specified by the Directions?

[60] https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10999

Para 15 of the directions specify that an NBFC-P2P shall:

(i) ensure that a policy is put in place, with the approval of the Board of Directors, setting out 'Fit and Proper' criteria to be met by its directors;

(ii) ensure that Directors meet the fit and proper criteria at the time of their appointment and on an ongoing basis, certify and inform the same to the Bank on a half-yearly basis;

(iii) obtain a declaration and undertaking from the Directors giving additional information, in the prescribed format;

(iv) obtain a Deed of Covenants signed by the Directors, which shall be in the prescribed format;

(v) advise RBI of any change of Directors, or key management personnel, and issue a certificate from the Managing Director/CEO of the NBFC-P2P that fit and proper criteria in selection of the Directors have been followed. The statement must reach the Regional Office of the Department of Non-Banking Supervision of RBI under whose jurisdiction the Registered Office of the NBFC-P2P is located, within 15 days of the change.

(vi) An annual statement shall be submitted by the CEO of the NBFC-P2P to the said Regional Office, giving the names of its Directors for the quarter ending on March 31, which should be certified by the auditors.

Further, RBI, if it deems fit and in public interest, may independently assess whether the directors are, individually or collectively, fit and proper and the NBFC-P2P shall remove the concerned director/s, on being advised it to do so.

58. Under what circumstances do NBFC-P2Ps require prior approval of the RBI?

Para 16 of the directions specify that prior approval of the Bank is required under the following circumstances:

a. any allotment of shares which will take the aggregate holding of an individual or group to equivalent of 26 per cent and more of the paid up capital of the NBFC-P2P;
b. any takeover or acquisition of control of an NBFC-P2P, which may or may not result in change of management;
c. any change in the shareholding of an NBFC-P2P, including progressive increases over time, which would result in acquisition by/ transfer of shareholding to, any entity, of 26 per cent or more of the paid up equity capital of the NBFC-P2P;

d. any change in the management of the NBFC-P2P which would result in change in more than 30 per cent of the Directors, excluding independent Directors;
e. any change in shareholding that will give the acquirer a right to nominate a Director.

59. Under what conditions are the NBFC-P2Ps free to act without prior approval of the RBI?

The directions specify that prior approval of RBI will not be required in case of any shareholding going beyond 26% due to buyback of shares / reduction in capital where it has approval of a competent Court. The same must be reported to RBI not later than one month from its occurrence.

60. How is the application for approval to be drafted?

The directions specific that the NBFC-P2P must submit an application, on the company letter head, for obtaining prior approval of the Bank, along with the following documents:

(i) Information about the proposed Directors/ shareholders in the prescribed format;
(ii) Sources of funds of the proposed shareholders acquiring the shares in the NBFC-P2P;
(iii) Declaration by the proposed Directors/ shareholders that they are not associated with any unincorporated body that is accepting deposits;
(iv) Declaration by the proposed Directors/ shareholders that they are not associated with any company, the application for CoR of which has been rejected by the Bank;
(v) Declaration by the proposed Directors/ shareholders that they have not been convicted of any crime and that there are no pending criminal cases against them, including proceedings initiated under section 138 of the Negotiable Instruments Act,1881; and
(vi) Bankers' Report on the proposed Directors / shareholders.

This application is to be submitted to the Regional Office of the Department of Non-Banking Supervision of the Bank where the company is registered.

61. Under what cases is the NBFC-P2P required to submit a Public Notice?

Para 16(4) and 16(5) of the directions specifies that a public notice of at least 30 days shall be given before effecting the following:

- sale or transfer of the ownership by sale of shares, or
- transfer of control, whether with or without sale of shares.

Such public notice shall be given by the NBFC-P2P and also by the other party or jointly by the parties concerned, after obtaining the prior permission of the Bank.

Further, Para 16(5) of the directions specify that the public notice shall indicate the intention to sell or transfer ownership/control, the particulars of transferee and the reasons for such sale or transfer of ownership/ control. The notice shall be published in at least one leading national and in one leading local (covering the place of registered office) vernacular newspaper.

62. What compliances are required in case of change of address, directors, auditors, etc.?

Para 16(6) of the directions state that every NBFC-P2P shall communicate, not later than one month from the occurrence of any change in:

(i) the complete postal address, telephone number/s and fax number/s of the registered / corporate office;

(ii) the residential addresses of the Directors of the company;

(iii) the names and office address of the auditors of the company; and

(iv) the specimen signatures of the officers authorised to sign on behalf of the NBFC-P2P to the Regional Office of the Department of Non-Banking Supervision of the Bank within whose jurisdiction the Registered Office of the NBFC-P2P is located.

63. What are the Reporting Requirements specified by RBI?

Para 17(2) states that the NBFC-P2P is required to submit the following:

(i) A statement, showing the number and amount in respect of loans;

a. disbursed during the quarter;

b. closed during the quarter; and

c. outstanding at the beginning and at the end of the quarter, including the number of lenders and borrowers outstanding as at the end of the quarter

(ii) The amount of funds held in the Escrow Account, bifurcated into funds received from lenders and funds received from borrowers, with credit and debit summations for the quarter.

(iii) Number of complaints outstanding at beginning and at end of quarter, and disposed of during the quarter, bifurcated as received from

a. lenders and

b. borrowers.

(iv) The Leverage Ratio, with details of its numerator and denominator.

64. To whom and by when are the aforesaid documents to be submitted?

Para 17(2) specifies that the aforementioned documents are to be submitted to the Regional Office within 15 days after the quarter to which they relate.

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