



PEER TO PEER LENDING IN INDIA

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FOREWORD¹

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

¹ As appearing in the previous instalment of the Report (2019-20)

growth in personal lending, at the same time, the growth in SME-focused lending or student loans has made good for the reduced volumes.

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."² 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. The UK also regulates P2P lending through its Financial Conduct Authority (FCA).

In India, the RBI has notified³ P2P lending 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-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, i.e., the economics of disintermediation. of course, such economics also need to take into account the structural risk that come with such disintermediation as has been highlighted by the RBI in its 25th Financial Stability Report⁴.

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

²<http://fessud.eu/financial-stability-risk-peer-peer-lending-new-payment-systems/>

³NBFC-P2P Master Directions notified by the RBI - https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11137

⁴ <https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1203>

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 connections of around 1.14 billion in October 2022 (as compared to approximately 1.16 billion, a slight dip of ~2% year-on-year)⁵ 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](#)⁶, 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.

⁵ As per Telecom Subscription Data available on the TRAI portal - <https://traigov.in/release-publication/reports/telecom-subscriptions-report>

⁶ 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 spread widely to Asian countries as well over the years and 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:

Indirect Lending

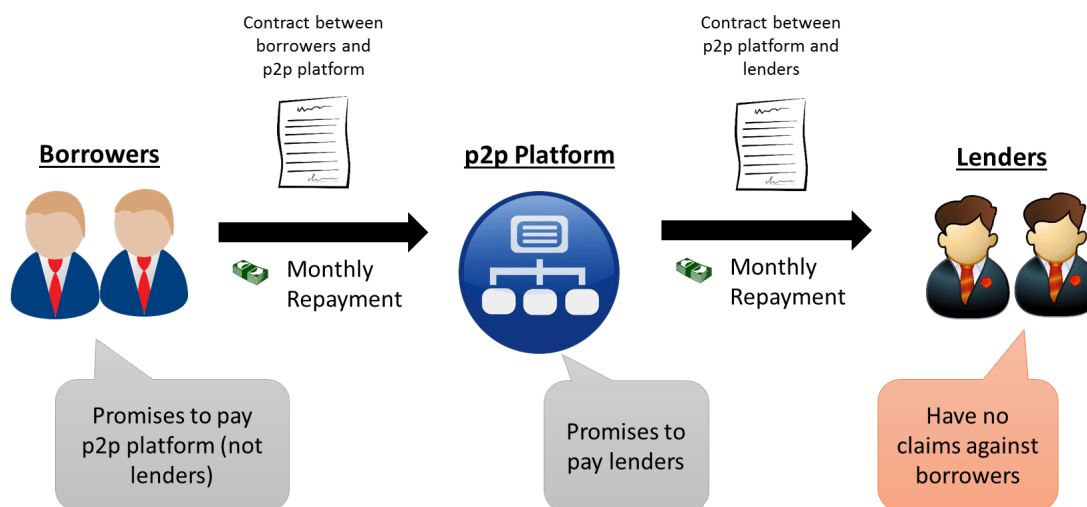


FIGURE 1: P2P LENDING PROCESS

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 preliminary 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 of 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 as well as individual loan contracts is directly transacted between the borrower and the lender, and the same is only monitored through the platform.

FROM P2P TO MARKETPLACE LENDING:

On the P2P platform, as the name implies, the lenders are "peers", and the borrowers are "peers". The idea seems to be a large, open-ended group of self-help lenders, lending on a mutual platform. Mutual lending groups have existed through centuries – cooperative credit societies have existed in India, and different other forms of mutual savings institutions have existed, world-over, in different ways. However, the P2P platforms break the limitations of mutuality, and extend the lenders and borrowers both to a completely open-ended democratic mass.

This is how P2P platforms began – with non-financial entities on both sides of the spectrum. In the USA, Lending Club and Prosper, the two leading platforms, will issue participation notes for the loans, funded by warehousing lines of credit, which will then get transferred to retail investors. However, this was soon seen as resulting into creation of a

“security”, and hence, attracting SEC regulations. In addition, with plenty of financial intermediaries’ money being available for retail lending, institutional investors would soon start gaining preponderance as investors on the platforms. Hence, the word P2P platforms soon gave way to “marketplace lenders”. That is, regulated lending entities will see the platform as a marketplace for loans.

P2Ps GROWING EDGE OVER BANKS?

As per the [Global Findex Database 2021](#), issued by the World Bank⁷, globally, about 1.7 billion adults remain unbanked—without an account at a financial institution or through a mobile money provider. The Federal Deposit Insurance Corporation estimated that, in 2018 approximately 6.5 % of US households were unbanked and 16% were underbanked.⁸ Of such unbanked population, nearly half live in just seven developing economies *including* 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.

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 banking⁹. 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

⁷ <https://www.worldbank.org/en/publication/globalindex>

⁸

<https://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-beyond-covid-19-new-opportunities-for-fintech-companies.pdf>

⁹ 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>

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 (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 P2Ps in India, but in a dialogue with ET, Faircent reported that P2P lenders would earn a gross return of 18-26%¹⁰.

A NASSCOM- KMPG report suggests that the P2Ps lending industry will grow into a \$4-\$5 billion industry by 2023¹¹ given its attractiveness. An interesting comparative has been made for investors on why P2Ps are worthy of consideration as an investment option¹²:

	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%

¹⁰

<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>

¹¹ <https://inc42.com/buzz/p2p-lending-fintech-loans/>

¹²

<https://p2plendingsite.wordpress.com/2017/06/30/12-benchmarking-p2p-alternative-vs-mainstream-returns/>

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 a loan to a similar customer.

BENEFITS OF P2P LENDING

P2P lending has, over a few years, brought 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 depicted 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.
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 their 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

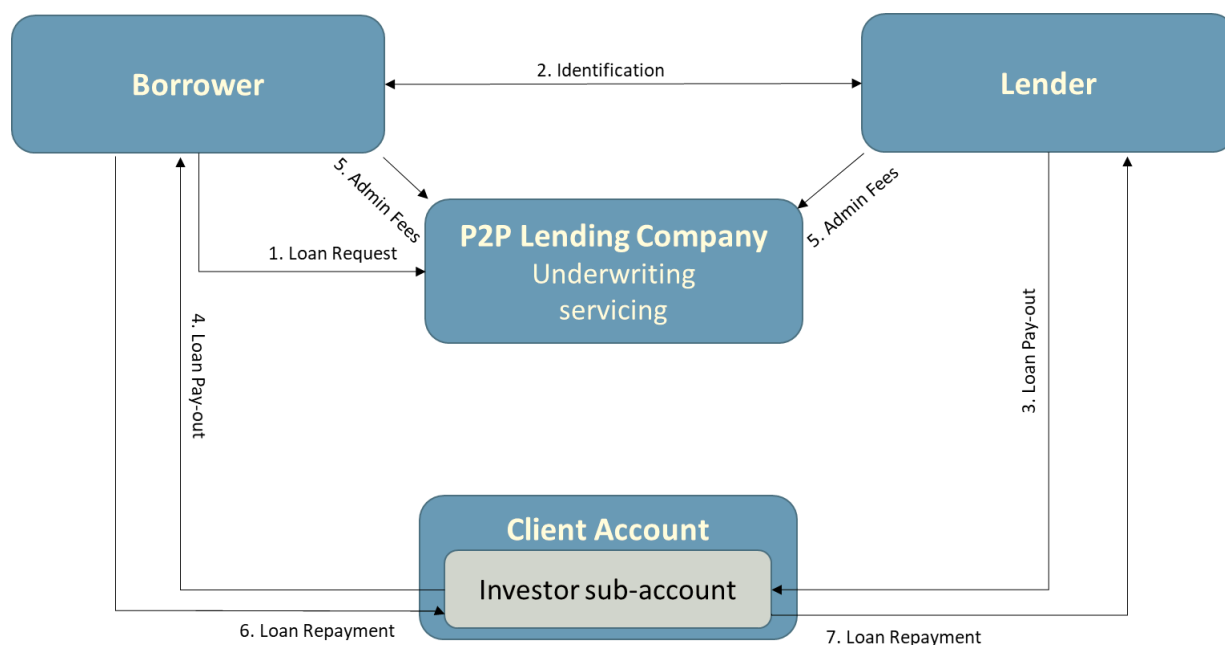


FIGURE 2: CLIENT-SEGREGATED ACCOUNT MODEL- GRAPHICAL REPRESENTATION

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

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 release 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). Release of funds in favor of the borrower, is acceptance of the borrower's request for the loan
4. These funds are then transferred into the Investor Sub-Account of the borrower for him to put to use
5. 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
6. At time of repayment, the borrower repays the amount by depositing the same into its Investor Sub-Account from where it travels into the lender's accounts
7. From the borrowers' Investor Sub-Account it travels into the lenders' accounts.

While these accounts are operated by the lenders and borrowers themselves usually, 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.

The name "segregated" implies that the amount put in by the lenders is put into a segregated account, maintained by the marketplace lender, from where the funding to the borrowers happens.

NOTARY MODEL

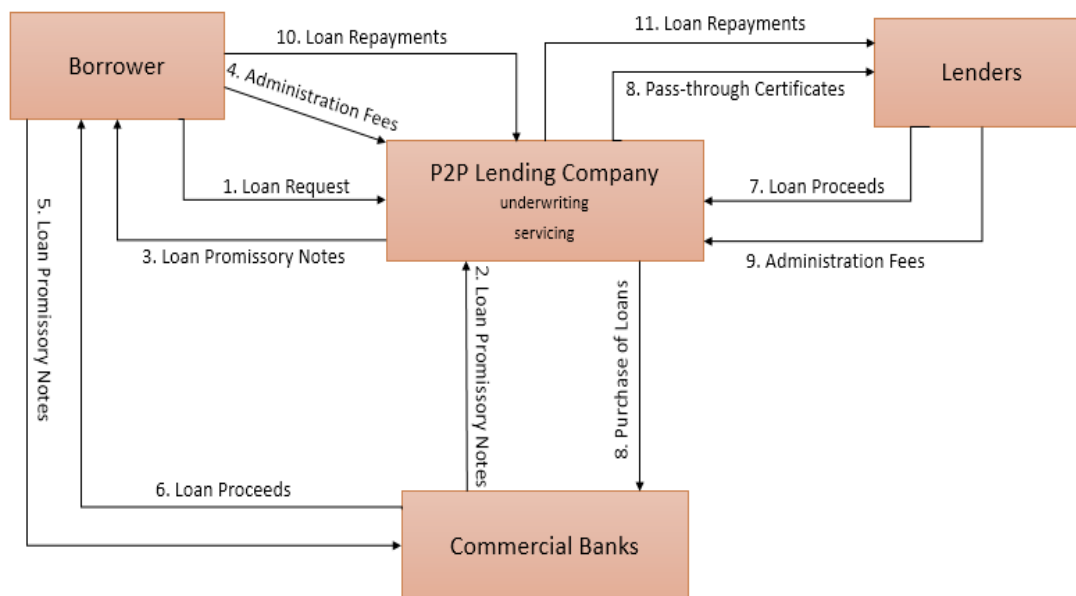


FIGURE 3: NOTARY MODEL-GRAPHICAL REPRESENTATION

This is a more 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 tradable 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 tradable 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 that was being used by the platforms such as Lending Club and Zopa.

OTHER STRUCTURES

Other structures have also emerged where the platform also has a 'skin-in-the-game' such as the 'Guarantee Model'. P2P marketplaces have also Fintech companies indulging in lending on their own balance sheet and assume the nature of a 'Balance Sheet Lender'. Such models, however, generally attract registration mandates and large P2P platforms, especially in the US, have secured full service banking licenses to continue operations.

GLOBAL OVERVIEW

PERFORMANCE OF P2P LENDING GLOBALLY

The P2P model of lending remains the most widely adopted model of lending, as the lending volume in 2019 , excluding China, totalled to \$33.6 billion constituting 37% of total global volume. In 2020 as well, the lending volume constituted 31% of the market share and quantified to a volume of \$34.7 billion¹³ (refer to the section on Impact of the pandemic in P2P lending). The global peer-to-peer (P2P) lending market is saw volume of \$80.19 billion in 2021 and is expected to grow to \$106.09 billion in 2022, albeit at a lower CAGR with the Russo-Ukrainian war disrupting global economic recovery from the COVID-19 pandemic.¹⁴

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 on 30th September, 2022, loan origination through P2P in UK amounted to £5.7 billion in 2018. 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, AltFi reports¹⁵ annual lending of £6.17 billion in UK in the year 2019. However, the annual volume for lending in the UK in 2020 declined to GBP 4.02 billion (£4.78 billion)¹⁶.

Further, statistics show that, the global P2P Lending Market is valued at USD 67.93 Billion in 2019 and expected to reach USD 558.91 Billion by 2027 with a CAGR of 29.7% over the forecast period.¹⁷

¹³

<https://www.jbs.cam.ac.uk/wp-content/uploads/2021/06/ccaf-2021-06-report-2nd-global-alternative-finance-benchmarking-study-report.pdf>

¹⁴

<https://www.globenewswire.com/news-release/2022/12/01/2565843/0/en/Peer-to-Peer-P2P-Lending-Global-Market-Report-2022-Ukraine-Russia-War-Impact.html>

¹⁵ <https://www.altfi.com/state-of-the-market>

¹⁶

<https://www.statista.com/statistics/797749/peer-to-peer-vs-bank-lending-uk/>

¹⁷

<https://www.alliedmarketresearch.com/peer-to-peer-lending-market>

The transaction volume in marketplace lending (consumer) segment is expected to reach US \$ 73,537.4 million in 2022, with a CAGR of 0.78% for the period of 2022-2025.¹⁸

With a growth rate of 51.5% annually¹⁹ from 2016 to 2022, 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.²⁰

The U.S. is the largest industry to date followed by UK and Europe excluding UK²¹. 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 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.²²

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

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<https://www.statista.com/outlook/338/100/marketplace-lending--consumer-/worldwide>

¹⁹ <https://www.theroute-finance.com/global-p2p-market-grow-52-annually/>

²⁰ <http://crowdexpert.com/crowdfunding-industry-statistics/>

²¹

<https://www.jbs.cam.ac.uk/wp-content/uploads/2021/06/ccaf-2021-06-report-2nd-global-alternative-finance-benchmarking-study-report.pdf>

²² <http://blog.peerform.com/2017-peer-to-peer-lending/>

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.

The US crowd funding industry sums up to 80-90% of the continent's crowd funding. However, The market size of the Peer-to-Peer Lending Platforms industry in the US has declined 9.3% per year on average between 2016 and 2021. As per IBISWorld, The market size, measured by revenue, of the Peer-to-Peer Lending Platforms industry is \$870.0m in 2021. In this context, S&P has assessed a 47% CAGR since 2015.²³

LendingClub is the largest P2P platform globally. From initiation of operation still date, LendingClub facilitated over US\$ 9K million of marketplace loan originations (as at Dec 31, 2022).²⁴

Prosper, meanwhile, is the second largest P2P player in the US - with total loans since origination in 2005 being around \$16 billion²⁵.

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 2019.²⁶

These 3 companies lead the US market, accounting for a total loan origination of around USD 24.068 billion in 2019²⁷. 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

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<https://www.spglobal.com/marketintelligence/en/news-insights/research/us-digital-lender-originations-expected-to-rebound-strongly-after-painful-2020>

²⁴ Ref Annual Report (10-K) filed in Feb 2023 - <https://ir.lendingclub.com/financials/Docs/Index/default.aspx?FilingId=16383130>

²⁵

<https://www.prosper.com/about-us/media/2018/08/13/prosper-reports-second-quarter-results-13-billion-loans-originated-since-inception/>

²⁶ <https://www.upstart.com/about#who-we-are>

²⁷

<https://learnbonds.com/news/top-5-countries-by-p2p-lending-volumes-in-2019-report/>

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.²⁸

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.²⁹

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 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 2019.³⁰ 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.³¹ The average age of loans being reported is around 3 months, majorly funding small businesses. Trailing it, Zopa has reported a figure of £5 billion³². 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.³³

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

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<https://www.lendacademy.com/prosper-announces-partnership-consortium-160-community-banks/>

²⁹ <https://www.lendacademy.com/my-returns-at-lending-club-and-prosper/>

³⁰ <https://www.altfi.com/state-of-the-market>

³¹ <https://www.fundingcircle.com/uk/>

³² <https://www.zopa.com/invest>

³³ <https://viainvest.com/blog/uk-p2p-lending-matures-into-a-key-market/>

protection³⁴. Additionally, constant government support such as regular investment in P2P and through P2P platforms have boosted its growth.³⁵ 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.³⁶

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.

With P2P platforms emerging as competitors of banks, the sector has also seen M&A activity with large players (like RateSetter) being acquired by banks.³⁷

CHINA

With the highest number of P2P operators, China was home to more than 6000 platforms in the world at one point of time. 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. In 2018, growth of China's P2P lending sector dramatically reversed, resulting in a drastic fall in the number of P2P lending platforms following a regulatory crackdown. EZubao, formed in 2014 by the Yucheng Group, was one of the largest P2P players in China, raising around CNY 50 billion in just 1.5 years. It offered returns of around 9-15%, with no limits on the amount or tenure of deposit. Operations were suspended by the Chinese Government due to the non-feasibility of its

³⁴ <http://p2pfa.info/about-p2p-finance>

³⁵

<https://www.gov.uk/government/news/new-40-million-investment-by-british-business-bank-to-support-450-million-of-lending-to-smaller-businesses>

³⁶

<http://www.businessinsider.com/uk-peer-to-peer-platforms-are-benefitting-from-government-policies-2016-8?IR=T>

³⁷ In August 2020, Metro Bank, a UK-based retail banking company, acquired peer-to-peer lender RateSetter for \$15.06 million. The acquisition would enable Metro Bank to achieve its goal of boosting unsecured lending and, profitability. RateSetter is a UK-based loan provider and a prominent P2P lending network that allows users to lend and borrow money directly from one another based on their own interest rates.

<https://www.globenewswire.com/news-release/2022/12/01/2565843/0/en/Peer-to-Peer-P2P-Lending-Global-Market-Report-2022-Ukraine-Russia-War-Impact.html>

scheme. A regulatory crackdown amid a deleveraging campaign on risky investments led to a collapse of the sector that had thrived in previous years by attracting retail investors with higher-than-usual returns. Issues with disclosure non-compliance, fraud activities or managers simply disappearing due to suspicion by the government. At the end of October 2019, the number of P2P platforms had reduced to a historical low of 572. The market volume contracted significantly and tumbled down from USD 358 billion in 2017 to USD 1.2 billion. According to a Reuters news report, from the high of 6000, the number of P2P has come down to a paltry 29 in Q3 2020.³⁸

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	<p>P2Ps are regulated by the 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.</p> <p>The states are allowed to apply different laws as per their suitability. Certain states have completely banned P2P business while some have placed restrictions on their financial capacity.</p> <p>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 disbursement process costlier and sophisticated.</p>	Securities and Exchange Commission (SEC) and State specific regulations
United Kingdom	2005	<p>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</p>	Financial Conduct Authority (FCA)

³⁸ <https://www.reuters.com/article/us-china-p2p-idUSKCN25A0FO>

		<p>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 laws³⁹ 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.</p> <p>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.</p>	
China	2007	<p>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 have occurred. CBRC amended the regulations to make them stricter.</p> <p>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.</p> <p>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.⁴⁰</p> <p>The changes were introduced to reinstate confidence in P2Ps. However, P2P lending activity has witnessed a drastic collapse post regulatory changes and enforcement action.</p>	China Banking Regulations Commission (along with Cyberspace Administration of China and Ministry of Industry and Information Technology)

³⁹ <https://www.fca.org.uk/publication/feedback/fs16-13.pdf>

⁴⁰ Other regulatory action including enhanced capital requirements were also enforced - <https://www.reuters.com/article/us-china-p2p-idUSKBN1Y2039>

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) ⁴¹ . 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. ⁴²	Canadian Securities Administrator (CSA)
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. ⁴³	-
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

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

⁴²

<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&>

⁴³ <https://www.lendacademy.com/marketplace-lending-japan/>

EMERGENCE OF MARKETPLACE LENDING PLATFORMS

There are two significant areas of development in the P2P lending space - one, is the foray of Big Tech into this space leading to a Big Tech vs FinTech scenario. The other is the complementary role that the lendingtech platform provide to financial institution lending on their own balance sheet. Thus we have -

Fintech Credit - Credit activity facilitated by electronic (online) platforms that are not operated by commercial banks, e.g. P2P/ marketplace lending.

Big Tech Credit - Large companies whose primarily business is technology ("big techs") have entered credit markets, lending either directly or in partnership with financial institutions.

In the second case, while peer-to-peer platforms are primarily aimed at non-institutional investors and as is mentioned earlier acts as 'spare tyre' to institutional lending, it has been observed that financial institutions are making use of this platforms as loan origination.

The notarial model that was popular in the US has fallen from favour, falling foul of securities laws (refer section on [Issue with P2P Lending](#)).

Marketplace lender ('lending service provider') have acquired licenses in order to make loans directly to borrowers. LendingClub - platform matching institutional investors/ financial institutions with borrowers and went on to acquire banking licence. In 2021, LendingClub also bought into the banking sector through its acquisition of Radius Bank, where it obtained their bank charter. Institutional participation in P2P platfors have risen and the recent annual report of LendingClub displays a favourable impact.

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 in 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

Chinese company Paipaidai was the first P2P platform in Asia founded in 2007 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. It was later 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.⁴⁴

According to Online Lending House, 4500 platforms have collapsed since 2013⁴⁵ on account of disclosure non-compliance, fraud activities or managers simply disappearing due to suspicion by the government.

UNITED KINGDOM

In the U.K. the cost of failed P2P ventures was marginal compared to China's. Quakle, a year old company, became insolvent due to 100% defaults in loans. The FCA released a statement declaring the bankruptcy of Quakle and the reasons for it as well.⁴⁶ 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.

⁴⁴ <http://fortune.com/2016/08/24/china-p2p-lending-regulation/>

⁴⁵

<https://www.livemint.com/Money/tuI4wvfqdbVH9nQVYC1M5I/Lessons-for-P2P-lending-in-India.html>

⁴⁶ <https://www.fca.org.uk/publication/final-notice/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.

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 credit information (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

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 principal 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 to require at least 20 lenders empanelled with itself to meet the requirements of the borrower. Thus, the platforms will have to have a 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 disbursement, 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.

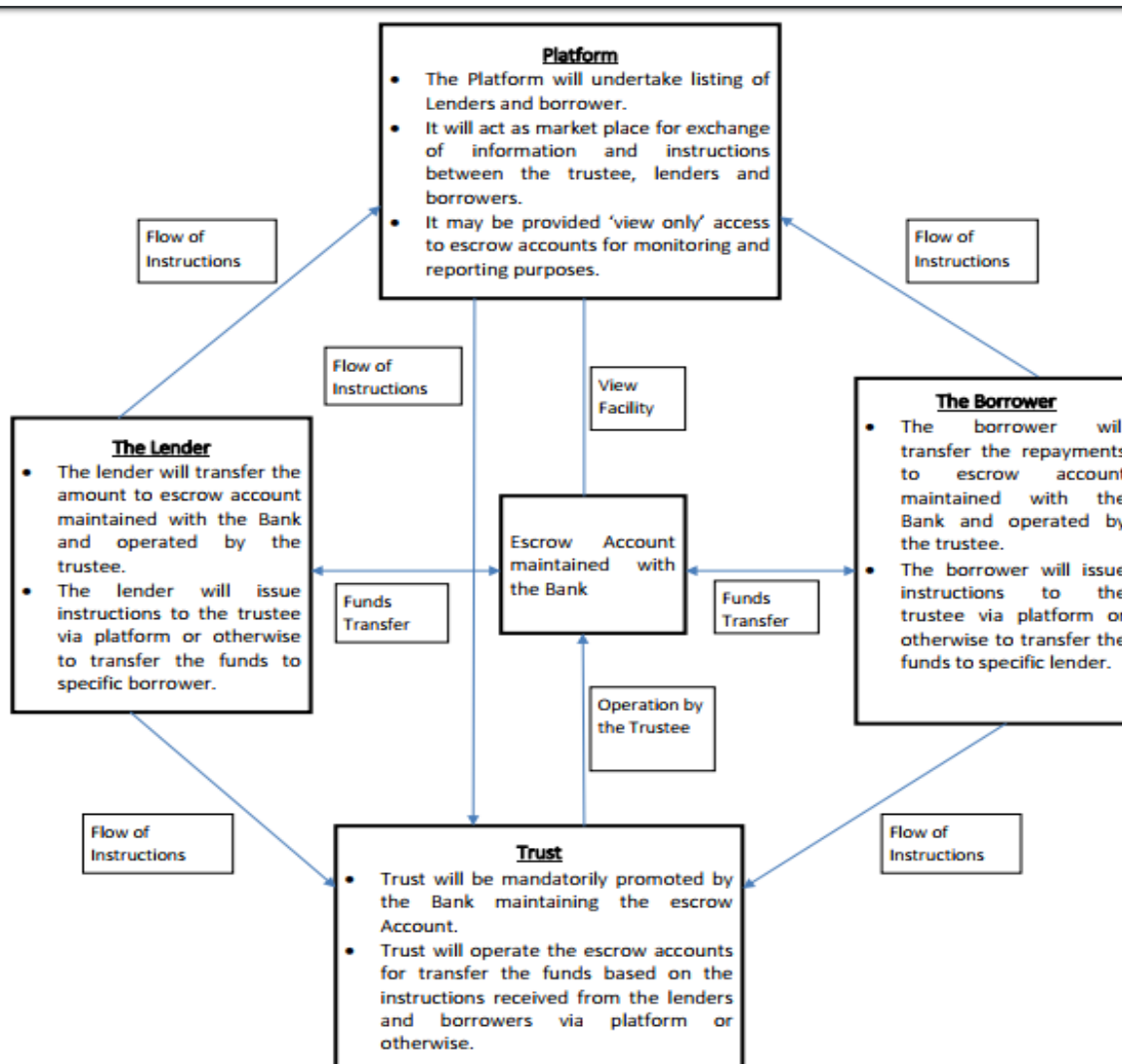


FIGURE 4: FUND TRANSFER MECHANISM-GRAPHICAL REPRESENTATION

The graphic provided in 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.

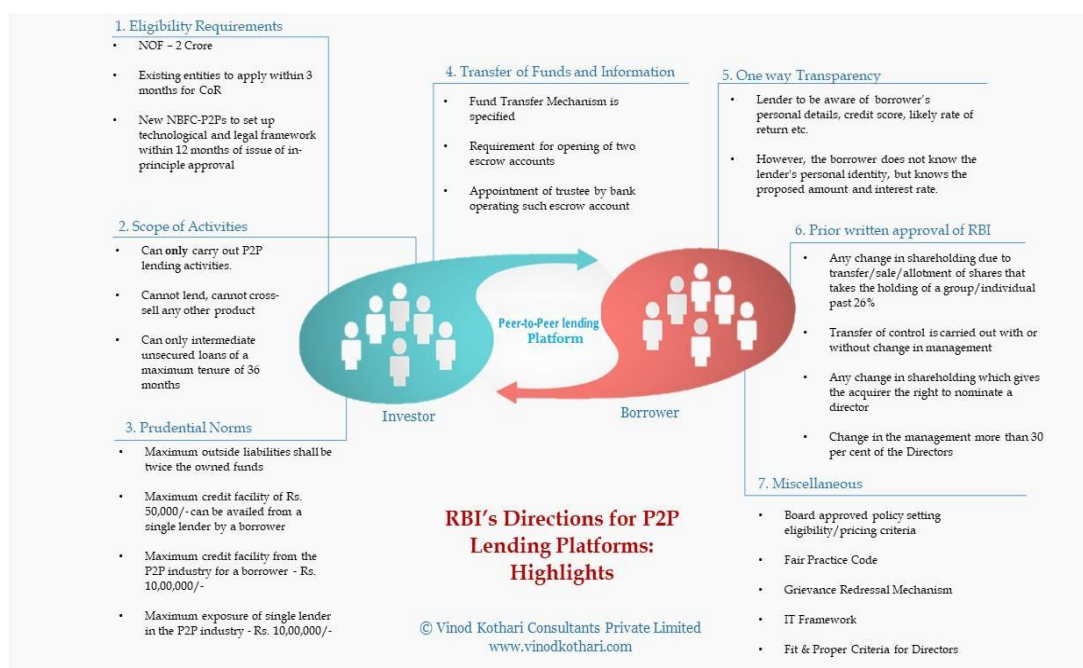


FIGURE 5: DIRECTIONS FOR NBFC P2Ps

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.

Regulations referenced in the Master Directions: Regulations with regard to Outsourcing and those related to Credit Information Companies (CIC)

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

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

SURVEY

A survey⁴⁷ was carried out during 2020-21 on the viability of P2Ps as an investment avenue in India. Our observations based on the survey and other publicly available information are presented in this section.

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.⁴⁸

DEFAULT AND RECOVERY PROCESS

As per data released, at the time regulations came into existence, by India's largest P2P lending platform⁴⁹ 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'

⁴⁷ Summarised responses to the survey is available in [Annexure - II](#).

⁴⁸

<http://www.thehindubusinessline.com/money-and-banking/p2p-lenders-may-be-allowed-to-operate-offline/article9832335.ece>

⁴⁹

https://www.faircent.com/sites/default/files/Portfolio_Newsletter_Rev_oct.pdf

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. Back in 2016, i2ifunding, one of the big players in the P2P ecosystem in India introduced the concept of 'Principle Protection Fund'⁵⁰, 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.⁵¹ 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 reaping benefits from the deal.⁵² 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

⁵¹

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

⁵²

<https://www.euromoney.com/article/b12kpntgmmgd31/bank-collaboration-with-p2p-platforms-rising>

The P2P regulations issued by RBI has shrunk the India's P2P lending industry. Currently there are only 25 P2P platforms registered with RBI as per the data released by RBI on December 31, 2022⁵³. 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.

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 more than Rs. 2500 crore⁵⁴

The P2P lenders are required to create and manage two escrow accounts, one for disbursement 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.

EXISTING MARKET PRACTICES

PLATFORM

Availability: Based on publicly available information out of 20 registered NBFC-P2P only 10 have active platforms⁵⁵ and there is a proclivity towards mobile apps with a single NBFC-P2P launching multiple apps so as to launch targeted products and address the specific needs of investors and partners

Matchmaking Process: Platform provide a variety of options for matchmaking between borrowers and lenders. This include public listing of individual loan requests for manual

⁵³ https://rbi.org.in/Scripts/BS_NBFCList.aspx

⁵⁴ https://www.faircent.com/lender_registration_campaigns_partner/

⁵⁵ based on whether the NBFC-P2p has an active weband mobile platform and provides updated portfolio performance

selection, application of bidding process for the borrower to decide, automatic matchmaking based on certain pre-specified criteria. Often plans are provided to the investors (lenders) generally based on risk profile and expected return and the plan portfolio is updated with loan requests based on the platform's proprietary algorithm ('blackbox'⁵⁶). **Other Services:** Other than matchmaking, execution of the loan agreement, disbursement as well as servicing are performed by the platforms. Credit assessment performed by the platform is substantially relied upon for the purposes of selecting loan requests. Platform often have tie-ups with insurers or financial institutions for the purposes of providing credit protection on behalf of borrowers. Secondary marketplaces for loans also offered on certain platforms providing early exit opportunities to lenders.

LENDER

Registration: Simple procedure is followed for Lender registration requiring submission of copies of basic KYC documents (PAN is usually insisted on and email/ mobile number OTP based verification performed). Nominal registration fee is charged and is waived by several platform. Platforms do not mention the need for either physical/ video based verification of lender identity or a detailed procedure for assessing creditworthiness. However, platforms generally insist on lenders transferring their investment in advance of the actual disbursement to the platform escrow account in order to ensure loan commitments are fulfilled.

Investment strategies: Registered lenders are offered a number of investment strategies other than being provided a list of loan proposals to pick from. Lenders can select plans or funds to invest in. Lenders are also provided options with regard to their investment horizon with fixed tenure or diminishing balance plans. Lenders also provided option to automatically reinvest any serviced amount or hold such repayments in the platform escrow account for manually reinvesting later. Only a handful of platforms provide for direct repayment from borrower to lender and lenders recoup their investments usually by withdrawing from the platform escrow account.

Fee charged: Fee charged from the lenders may be divided under the following heads -

- Fixed charges:
 - Platform registration fee,
 - Documentation/ processing fee per loan or plan invested in
- Transaction value linked charges:
 - Servicing fee as a percentage of loan disbursed/ investment amount,
 - Recovery charges as a percentage of amount recovered
- Return linked charges:
 - Step-up rates linked to APR/ actual ROI
 - Sweeping returns over a specified threshold rate
- Contingent charges:
 - Withdrawal charges over a specified limit

⁵⁶ The specific criteria and process being used by such algorithm is not disclosed.

The above charges are an inclusive list as disclosed by the platforms on their websites. Certain platform also levy other charges such as escrow recharge charge that is a fixed amount charge on every recharge not in specified multiple.

Withholding tax: The platforms generally do not withhold tax for the purposes of TDS on withdrawals. The platforms do provide statement of returns that lenders can use for the purposes of calculating their tax liability.

BORROWER

Sourcing: The platforms provide direct access to borrowers, against a nominal registration fee, to list their loan proposals. Another interesting practice is the use of platform partners, tie-ups with professional and agencies, for loan origination.

KYC: Compared to lenders, the published KYC process for borrowers has greater rigour. cKYC, verification based on aadhar details are some of the methods for performing customer due diligence. Platforms also perform physical verification at least on a sample basis.

Credit Assessment: As mentioned earlier, sanction of loans is largely based on the credit assessment provided by the platform. Borrowers are usually slotted into specific categories (risk profiles) or allotted credit scores based on proprietary underwriting algorithms used by the platforms. These categories determine the APR quoted for these loans as well as whether the loan proposals get listed on the platform. The algorithm's use traditional underwriting methods such as use of bank statements, tax returns and salary statements as well as alternative mechanisms based on social and demographic criteria.

Collateral/ credit risk protection: The platforms almost exclusively cater to unsecured personal loans. However, execution of nACH mandates/ direct debit is generally insisted from the borrowers. Additional comfort is also sought in the form of post dated cheques executed in the name of the lender/ platform trustee. For the purposes of boosting their credit profiles borrowers may also execute life, disability, loss of livelihood/ employment insurance with the lender or platform trustee as the payee.



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 2179688⁵⁷. 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 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 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

57

<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>

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, 2019⁵⁸.

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?

SYNTHETIC STRUCTURES

OFFLOADING LOANS

P2P lending platform are also found to advertise themselves as platform where refinancing may be obtained allowing borrowers stuck with high interest cost to refinance such loans with more competitive rates. However, with the opacity of such platforms, especially, related to lender identity it may also be used by institutional lenders to offload their existing loan commitments to retail participants registered on such platform.

PLATFORM AS PARTICIPANT

The term 'Marketplace Lending' has been used to refer to lending practice using a platform that acts as a marketplace where lenders and borrowers are brought together and transact. The platform itself does not lend using its own funds or assume the credit risk arising from such financial transaction and merely acts as a technology intermediary ('lendingtech' provider). Lenders that provide funding or assume the credit risk arising out of such transactions on the platform are termed as 'Balance Sheet Lenders' and are already in the business of 'balance sheet lending' and are generally regulated entities under the financial regulator in such jurisdiction. In Marketplace Lending structures, however, lending practices have emerged whereby the platforms themselves go beyond the role of mere intermediaries and assume credit risk on their balance by providing a part of the funding or by using other off-balance sheet methods such as guarantees. Such guarantees may be in the form of partial principal protection or by assuring a rate of return against a fee or in return for sweeping any residual return. While such practices create a 'skin in the game' for the platform provider especially when it comes to the platform providing underwriting services beyond merely acting as a listing board it also leads to spreading of substantial credit risks beyond regulated entities that are guided by regulatory capital and other prudential requirements.

PARTNER TIE UPS

P2P Lending Platform are naturally incentivised to provide a large and diversified loan portfolios and tie ups are developed with partners, generally players in the financial service, for the purpose of sourcing of loans. Such partnerships come with corresponding

commitments to find lending partners or provide associated financial services like insurance or servicing contracts.

APPLICABILITY OF SECURITIES LAWS

AGGREGATION AND FRACTIONALISATION

P2P Lending platforms witness both loan aggregation and fractionalisation - while a single investment commitment by a lender may be spread across multiple borrowers/ loans, a single loan may be funded by multiple lenders. The quantum of the funding requirement may be an organic motivator for such fractionalisation, however, such slicing, dicing and admixing is advertised to be undertaken to provide participants (lenders) on the platform a diversified portfolio of loans to invest in. There is thus a creation of a corpus/ fund as well as creation of bite-sized lots for allowing retail participation in the nature of collective investment schemes. With commercial and institutional loans also being registered on the P2P platform, the platform also assumes the complexion of a retail bond trading platform.

SECONDARY MARKET

Lenders can opt to list their existing loans for sale, as well as buy loans that have been listed on the platform provided marketplace. The lenders have to define the sale/ purchase specifications and if a buyer is available with a matching requirement, the transaction, generally in the nature of an assignment, is executed vide the platform.

Such practices have enforcement action on the part of security market regulators and reference may be drawn to the P2P note program that used to prevail in the US]

VALIDITY OF ELECTRONIC AGREEMENT AND CONSENT

VALIDITY OF CLICK-WRAP/ BROWSE-WRAP

The loan agreement between the lender and borrower is the central contract that arise out of a P2P lending transaction. There are, however, other contractual agreements and legal disclosures that need to take place among the platform and its participants (lender/ borrower). Legal disclosures arise out of the operation of statutes and regulations such as the Information Technology Act, 2000, the Sensitive Personal Data and Information Regulations, corresponding RBI Regulations, etc., that put onus on the P2P lending platform to provide disclosures to and obtain consent from the participants for certain actions performed by the platform. Prevailing market practices of such P2P platforms also require establishment of contractual relationships with its participants especially because of additional services that the platform provides and transfer of funds taking place between the participant and the platform often without the presence of an identified peer at the time of such transfer.

When it comes to electronic agreements and means of obtaining consent, courts in various legal jurisdictions have applied various tests to determine their validity, these include -

- whether the party providing consent had appropriate access to the information that was needed for and conditional to such consent,

- merely providing the digital path to to obtain the legally mandated disclosures cannot be considered in itself as providing the disclosure,
- merely continuing to browse the platform's website/ application, or use of the service of the platform or agreeing to use the platform cannot on their own be regarded as consent of the party or give rise contractual obligations on their part especially if the terms and conditions to which consent is provided are not conspicuously presented to such party.

Hence, P2P lending platforms need to take particular attention as to how their website/ apps are designed, how information is disclosed and made available to participants and the use of brose-wrap and click-wraps forms of obtaining consent.

ELECTRONIC EXECUTION AND DOCUMENTATION OF LOAN AGREEMENTS

Another interesting aspect of eletronic contract execution and documentation when it comes to P2P platforms is the nature of and the method used to execute the loan agreement. One of the peculiarities of a P2P lending platform is the opacity between the lender (the investors) and the borrowers. Although, the lending arrangement is supposedly peer-to-peer, ie., between the lender and the borrower; it is the platform that acts as the proxy counterparty and the platform is at a disadvantage when it comes to avoinding litigation, arising from such agreement, on the grounds of privity of contract.

On the other hand, the platform and its participants should take adequate care when it comes to protecting their own interest especially when it comes to electronically executed agreements. With participants registered on the platform unlikely to possess the means of affixing digital signatures, the platform uses various modes of electronic signatures and courts in various legal jurisdictions have applied various tests to determine the validity of such execution. The tests generally include checking -

- how identification is verified. One must be able to resonably describe the process of verification and that the process was verified at the time of execution
- that the signature creation data is linked only to the executing party and was under the control of such party at the time of execution
- any alteration of the signature is detectable
- alteration to the contents of the agreement made after the authentication/ execution is detectable

Legal provisions covering electronic signature are covered under the Information Technology Act and Schedule II of such Act and the Rules framed thereunder. According to section 3A of the Act that deals with the authentication of electronic records, the authentication technique may be specified in Schedule II and is considered reliable. The principles for determining reliability are specified in sub section 2 of section 3A and are on the same lines as mentioned above.

In light of the recently introduced Digital Lending Guidelines⁵⁹ of the RBI another important aspect to note is the extent of rigour applied to lenders and lending service providers. These Guidelines provide explicit directions with regard to the mode of execution and the sharing of loan agreements, disclosures and policies with the borrower. While the RBI's extant P2P Master Directions put an onus on the platform to undertake documentation of loan agreements and other related documents the question arises as to whether for regulated entities referred to in the Digital Lending Guidelines, the same directions should apply as a p2p lending platform, on the basis of the universe of service it provides, essentially forms a sub-set of digital lending applications⁶⁰.

CUSTOMER DUE DILIGENCE, CUSTOMER IDENTIFICATION AND KYC

As with other P2P practices, especially in the payments segment, customer due diligence, AML and tax avoidance have been particular bugbears in the P2P lending segment as well. Especially, with light weight due diligence carried out on the platform participants.

INFORMATION SECURITY AND PRIVACY

STATUS UNDER THE INFORMATION TECHNOLOGY ACT AND RELATED REGULATIONS

With the P2P platform acting as a technology bridge between lenders and borrowers, the platforms have self identified as 'intermediaries' as defined under the Information Technology Act, 2000. Such a classification provides "safe harbour" with respect to the content that is hosted on or transmitted through the platform by the participants. However, classification as an intermediary, in the context of the said act, bring with obligations with respect to data privacy and related disclosures. P2P lending platforms are also wont to hold or transmit 'sensitive personal data or information', especially financial data, and this puts additional onus on the platforms to obtain prior written consent for obtaining/ storing or transmitting such data, intimation of security incidents to CERT-In, application of reasonable security measures including the need to perform information systems audit by an external auditor to assure compliance, etc.

The RBI Master Direction for P2P lending platforms also impose on such platforms information systems and cybersecurity mandates that are applicable to systematically important NBFCs. Given the number of regulatory touch points that apply to the P2P platforms when it comes to information security and privacy, the likelihood of non-compliance, and corresponding impact, is quite high.

CREDIT ASSESSMENT METHODS

⁵⁹ https://rbi.org.in/Scripts/BS_CircularIndexDisplay.aspx?Id=12382

⁶⁰ Digital Lending Application (DLA) has been defined as Mobile and web-based applications with user interface that facilitate digital lending services. DLAs will include apps of the Regulated Entities (REs) as well as those operated by Lending Service Providers (LSPs) engaged by REs for extending any credit facilitation services in conformity with extant outsourcing guidelines issued by the Reserve Bank.

Marketplace lenders especially fintechs rely not only on traditional means of credit underwriting based on financial information (salary statements, tax returns, etc.) but also on alternative and innovative methods based on social, demographic and consumption profile of the borrower. Such practices have often been held to discriminatory in western jurisdictions. On a more universal context, the underwriting algorithms often being a blackbox, borrowers are left in the dark as to the specific reason their loan applications get rejected.

Alternative methods of credit assessment also may infringe upon the privacy rights of platform users, while the RBI has come out with rather detailed guidelines related to privacy and consent requirements when it comes to digital lending applications, the question of pari materia applicability to P2P lending platforms remain an open question.

Another area of concern is the mode of credit enquiry that the marketplace lenders conduct with credit bureaus. Credit scoring methodologies usually have take into consideration the frequency of credit enquiries by lending institutions with a high frequency of enquiries detrimental to the score ('hard credit check'); while an enquiry either performed by the individual themselves or on behalf such user ('soft credit check') does not impact the score. Given that platforms are in the nature of financial companies, borrowers must be appropriately made aware of the impact of the platform's credit enquiries on their creditworthiness.

RECOVERY METHODS

Marketplace lenders are also known to use recovery tactics that involve publicly publishing default information, posting on social media profiles or contacting the borrower's contacts based on their profile information ('soft scare'). Such tactics may fall foul of fair practice codes framed by financial market regulators or industry bodies.

FINTECH CREDIT: A DISRUPTION IN SHADOW BANKING SPACE

One of the notable areas of development in NBFIs space has been the evolution of FinTech credit. The term FinTech credit may be used to denote various business models⁶¹. 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

⁶¹ 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.

to as “loan-based crowdfunders”, “peer-to-peer (P2P) lenders” or “marketplace lenders”.⁶² 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.”⁶³

The global Fintech industry’s market size was valued at about \$110.57 billion in 2020, and is expected to grow at a CAGR of 9.2 p.a. to reach about \$ 158,014.3 million by 2023. Further, the market is expected to grow at a CAGR of 10.2% to \$191,840.2 million in 2025.⁶⁴

Relative size of Fintech is quite significant in several countries such as US wherein the fintech investments amounted to a total of \$9.4 billion in H1 2019 followed by the UK and Singapore in which the fintech investments amounted to \$ 2.29 billion and \$ 735 million respectively.⁶⁵

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 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

⁶²

<https://www.fsb.org/wp-content/uploads/CGFS-FSB-Report-on-FinTech-Credit.pdf>

⁶³ https://www.bis.org/publ/qtrpdf/r_qt1809e.htm

⁶⁴ <https://www.thebusinessresearchcompany.com/report/fintech-market>

⁶⁵

https://findexable.com/wp-content/uploads/2019/12/Findexable_Global-Fintech-Rankings-2020exSFA.pdf

Jurisdiction	Tax incentives	Regulations	Licensing / authorisation	Investor protections	Risk management requirements ⁶⁶
Australia	-	-	-	-	-
Brazil	-	Yes	Yes	Yes	-
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 ⁶⁷	-	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 measures⁶⁸

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

⁶⁶ Specific rules for fintech credit that are separate from pre-existing rules for other financial intermediaries.

⁶⁷ New rules effective from 2019. Sources: CGFS-FSB (2017); national authorities

⁶⁸ https://www.bis.org/publ/qtrpdf/r_qt1809e.htm

challenges for regulators in relation to the regulatory perimeter and monitoring of credit activity”.⁶⁹

CONCLUSION

Lenditech including 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.

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 billion⁷⁰ 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.

69

<https://www.fsb.org/wp-content/uploads/CGFS-FSB-Report-on-FinTech-Credit.pdf>

70

<https://www.morganstanley.com/im/publication/insights/investment-insights/ii-anintroductiontoalternativelending.pdf>



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.



IMPACT OF COVID-19 ON THE P2P LENDING INDUSTRY

MARKETS HIT BY THE PANDEMIC

The unprecedented covid crises had a significant bearing on the entire economy. With markets shutting down and technically all things coming to a halt, the business segment faced an economic crunch and downfall in practically all realms of its functioning. The root cause of the problems lies in the paucity of liquid funds with the business entities, as the pandemic interfered with the regular flow of money.

With restricted physical movement and most of the things going in online mode, the brick-and-mortar banks also become partly redundant whereas the digital lending platforms withstood the disruptive pandemic and proved to be much resilient than the former. Globally, the P2P lending volumes rose from \$ 89 billion in 2018 to \$ 91 billion in 2019. The volumes further rose by 24% in 2020 to sum up to \$113 billion indicating strong presence of P2P players.⁷¹

These platforms proved to be beneficial from a multi-stakeholder perspective. From the borrowers perspective, the online platforms during these times were preferred due to the convenience, and most importantly, the safety they offered – as the customers had funds available on the tap, they were not required to go out to obtain finance. In this context, the pandemic marked a growing popularity of the alternative finance space. Further, these companies provided the borrowers, a fair share of relief from the repayment obligations as the pandemic surged. For instance, P2P platforms like Lendingclub waived off the late fee on repayment of its loans.⁷²

From the lender's perspective, the P2P Lending platforms became an alternate investment avenue which offered a comparatively stable return than the conventional modes of investment.

The P2P lending businesses have also gained popularity amongst the institutional investors, as the latter financed approximately \$ 28.5 billion of the market volume in 2019 which rose to approximately \$ 43.6 billion of the market volume in 2020.⁷³

⁷¹

<https://www.jbs.cam.ac.uk/wp-content/uploads/2021/06/ccaf-2021-06-report-2nd-global-alternative-finance-benchmarking-study-report.pdf>

⁷²<https://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-beyond-covid-19-new-opportunities-for-fintech-companies.pdf>

⁷³

<https://www.jbs.cam.ac.uk/wp-content/uploads/2021/06/ccaf-2021-06-report-2nd-global-alternative-finance-benchmarking-study-report.pdf>

The P2P Lending seems more established in the corporate sector, as globally, the P2P lending in the business segment rose by 4% year on year basis in 2020.⁷⁴ While P2P Lending in other segments, such as consumer lending and property lending declined by 8% and 11% respectively.

In the corporate sector too, P2P Platforms were popular among the MSME businesses. Such fame may be owed to comparatively low requirements regarding collateral and other procedural aspects, when compared to traditional banking system. This type of credit absorption may also be attributed to the unfulfilled credit needs of the MSMEs. In this context, MSMEs remain highly underfinanced, as indicated by the Internal Finance Corporation. It states that approximately 40% of the MSMEs have financial needs amounting to \$5,200 billion which remain unfulfilled.⁷⁵ In Indian context, the Fin-Tech Association for Consumer Empowerment reveals that availing loans through digital platforms has proven to be a boom for the MSMEs and has given approximately 30-40% cost advantage to the MSMEs.⁷⁶

MARKET SCENARIO IN INDIA DURING THE PANDEMIC

The P2P lending in India is gaining its momentum after the pandemic. Even though India witnessed slightly tumbling numbers in terms of volume, the event ensured the platform's reach to the lower stratas of the economy. In this context, India gained the top position in the Asia Pacific region with respect to P2P Lending in the consumer segment for the years 2019 and 2020, with volumes totalling to \$ 1049.7 million and \$ 777.3 million respectively.⁷⁷ The boom was for not just the P2P Platforms extending business loans, but P2P platforms distributing personal loans as well. A report by LenDenClub revealed that almost 35% of the loans taken through such platforms may be attributed to medical emergencies during the pandemic.⁷⁸

⁷⁴

<https://www.jbs.cam.ac.uk/wp-content/uploads/2021/03/2020-ccaf-global-covid-fintech-market-rapid-assessment-study-v2.pdf>

⁷⁵

<https://economictimes.indiatimes.com/small-biz/sme-sector/funding-and-msmes-can-banks-fintech-together-address-the-credit-gap-for-small-businesses/articleshow/81087510.cms?from=mdr>

⁷⁶ Ref. The 2nd Global Alternative Finance Market Benchmarking Report (Cambridge Centre for Alternative Finance, June 2021) - <https://www.jbs.cam.ac.uk/wp-content/uploads/2021/06/ccaf-2021-06-report-2nd-global-alternative-finance-benchmarking-study-report.pdf>

⁷⁷

<https://www.jbs.cam.ac.uk/wp-content/uploads/2021/06/ccaf-2021-06-report-2nd-global-alternative-finance-benchmarking-study-report.pdf>

⁷⁸

<https://ibsintelligence.com/ibsi-news/millennials-dominate-p2p-lending-and-borrowing-report/>

The P2P platforms, during this time came up with innovative products – for instance, Faircent introduced “Anti- lockdown loans” to facilitates small businesses in India survive the pandemic. The product offered a loan of upto Rs. 75000 and EMI- free loans for an initial tenure of 3 months, followed by easy and affordable repayment options.⁷⁹



CONCLUSION

All in all, the pandemic paved a way for the P2P platforms to reach the segments which were untouched by the banking system. The governments too, seek to promote the fintech industry – obviously in a regulated manner, as they facilitate credit penetration in the society. It is to be seen if the platforms maintain their rapport or if the surge was a one-off thing.

ANNEXURES

ANNEXURE I: FAQs ON RBI REGULATIONS ON P2P LENDING PLATFORM

APPLICABLE REGULATIONS

What are the applicable regulations to P2P Lending Platforms?

P2P Lending Platforms are governed by the RBI based on powers granted to it under sections 45IA, 45JA, 45L, and 45M of the Reserve Bank of India Act, 1934 ('RBI Act').

P2P Lending Platforms registered as such with the RBI ('NBFC-P2P') are governed by the Master Directions - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017 (as updated on December 29, 2022) ('P2P Master Directions')⁸⁰.

Additionally, with the introduction of the Scale-based Regulation Framework ('SBR Framework')⁸¹, NBFC-P2P also get classified as NBFC Base-layer entities ('NBFC-BL') and are required to follow the RBI Master Direction - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 (Updated as on December 29, 2022) ('NBFC-BL Master Directions')⁸².

PEER-TO-PEER LENDING PLATFORM APPLICABLE REGULATIONS

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

As per Para 4(1)(v) of the P2P Master 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.

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.

What are the conditions for being classified as a 'P2P Lending Platform' under the RBI Directions?

As per P2P Master 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 it to lend on it or to avail of loan facilitation services provided by it.

⁸⁰ P2P Master Directions - https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11137

⁸¹ SBR Framework - https://rbi.org.in/scripts/FS_Notification.aspx?Id=12179&fn=14&Mode=0

⁸² NBFC-ND-NSI Master Directions - https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10585

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 on any P2P Lending Platform, lenders as well as borrowers need to be registered with the P2P Lending Platform.

Will any intermediary connecting participants be considered as a P2P Lending Platform?

RBI in its FAQs⁸³ on NBFC P2P Lending Platform has clarified -

Would electronic platforms serving as Direct Service Agents (DSA)/ Business Correspondents for banks and/ or NBFCs fall under the purview of the NBFC-P2P Directions?

Ans: Electronic Platforms that assist only banks, NBFCs and other regulated AIFIs to identify borrowers are not to be treated as P2P platforms. However, in cases where, apart from banks or NBFCs or AIFIs, other retail lenders use the platform for lending, the platform will have to register separately as an NBFC-P2P.

From the FAQ, we are able to infer DSA/ Business Correspondents, whether electronic platforms or otherwise, for banks and/or NBFCs, do not fall under the purview of the P2P Master Directions. This is, however, subject to the condition that such intermediaries are not utilised by retail lenders.

Hence, the P2P Master Directions consider intermediaries, other than the exceptions mentioned above, connecting lenders with borrowers as P2P Lending Platforms.

What is meant by loan facilitation?

The phrase 'loan facilitation' appears in the definitions of "Participant" and "Peer to Peer Lending Platform". It means connecting lenders and borrowers using the Platform. In undertaking the process of loan facilitation, however, the P2P Master Directions put an onus on it to perform due diligence of its Participants as well as perform credit assessment and risk profiling of borrowers to be supplied to lenders. .

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

Exclusivity is not observed in peer to peer platforms as such platforms merely act as conduits linking participants on such platforms so that they may transact among themselves.

The P2P Master Directions do not delve into whether there is a single, a few or many lenders on the Platform. Instead it focuses on participants on the P2P Lending Platform loan facilitation services from such a platform. Hence, even a P2P Lending Platform with a single

⁸³ RBI FAQs on NBFC P2P Lending Platform - <https://m.rbi.org.in/scripts/FAQView.aspx?Id=124>

lender may need to be registered as an NBFC-P2P if it has multiple Participants registered on it.

The RBI, however, has clarified in its FAQs⁸⁴ that DSAs even if electronic platforms need not register themselves as NBFC-P2Ps.

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

Refer to the response above.

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

Exclusivity is not a feature of peer to peer platforms as such platforms merely act as conduits linking participants on such platforms who may transact among themselves. In such a case the platform is expressly floated in the name of the lender and in such capacity and there is no intention to onboard other participants on such a platform. Hence, it shall not constitute a P2P Lending Platform.

Such a lender, however, may be considered as an RE under the Digital Lending Guidelines if such lending is carried out “majorly” using digital technologies.⁸⁵

What type of loans can be extended through the platform?

The P2P Master Directions put a bar on secured loans being extended through the P2P platform.

Unsecured loans or clean 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.

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 may exist one-way opacity, however, at the time of loan agreement execution identity may be verified.

REGISTRATION AS NBFC-P2P

⁸⁴ *ibid.*

⁸⁵ RBI Guidelines on Digital Lending - <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/GUIDELINESDIGITALLENDINGD5C35A71D8124A0E92AEB940A7D25BB3.PDF>

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 platform.
- 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.

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 using the specified form⁸⁶ for registration to the Department of Non-Banking Regulation, Mumbai.

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

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

What is the validity period of an in-principal approval?

The validity of the in-principle approval issued by RBI will be twelve months from the date of granting such in-principle approval within which the company must put in place the technology platform, enter into all other legal documentations required and report position of compliance with the terms of grant of in-principle approval to the Bank.

The RBI after being satisfied that the entity is ready to commence operations, grant a CoR as an NBFC-P2P, subject to conditions as deemed fit by the Bank.

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 and report position of compliance with the terms of grant of in-principle approval to the Bank.

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 complying with the conditions laid down by the RBI. 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 may 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.

⁸⁶ Forms are available here - https://rbi.org.in/Scripts/BS_ViewForms.aspx

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. 4th October, 2017. Existing P2P Lending Platforms are free to continue operating as a P2P lending platform till their certificate for issuance of CoR has been rejected and subject to such other conditions, including winding down, that the RBI may impose .

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

Refer to FAQ above.

REVOCATION OF REGISTRATION**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.

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.

PARTICIPANTS - ELIGIBILITY CRITERIA**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. 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 (including lenders).

Additionally, para 7 of the P2P Master Directions specify that a certificate with respect to adherence to prudential norms need to be collected by the P2P lending Platform from the lenders in terms of -

- The aggregate exposure of a lender to all borrowers at any point of time, across all P2P platforms, is within the cap specified (₹50,00,000/-) and that such investments of the lenders on P2P platforms are consistent with their net-worth. For a lender investing more than ₹10,00,000 across P2P platforms a certificate from a practicing Chartered Accountant certifying that its networth is at least ₹50,00,000.
- The exposure of a single lender to the same borrower, across all P2Ps, shall not exceed ₹50,000/-.
- The maturity of the loans shall not exceed 36 months.

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

A borrower is also considered a participant on the P2P Lending Platform and the platform should have a Board approved policy regarding the qualifying criteria for such participants as well.

Additionally, para 7 of the P2P Master Directions specify that a certificate needs to be procured from borrowers that The aggregate loans taken by a borrower at any point of time, across all P2Ps, is within the specified cap (₹10,00,000/-).

Can loans extended on P2P Lending Platforms be disbursed internationally?

P2P Lending Platform must ensure that there is no international flow of funds and the participant adheres to legal requirements under applicable laws.

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

Refer to prudential norms mentioned in FAQs above.

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

Refer to prudential norms mentioned in FAQs above.

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.

FINANCIAL AND OPERATIONAL GUIDELINES

What is Leverage Ratio?

The P2P Master Direction require NBFC-P2P to maintain a maximum leverage ratio of 2. As per para 4(1)(ii) of the RBI directions, Leverage Ratio is defined as Total Outside Liabilities divided by Owned Funds. In the FAQs published by the RBI it has clarified that Customers'

(participants) funds lent/ borrowed by using the platform is not reckoned as outside liability of the platform.

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.

Do the P2P Master Directions provide any operations guidelines for the platform?

An NBFC-P2P must have a board approved policy in place describing the:

- i. Eligibility criteria for participants on its platform;
- ii. Pricing of services provided by it;
- iii. Rules for matching lenders with borrowers in an equitable and non-discriminatory manner.

The platform itself will be held liable for the activities outsourced by it and for the actions for service providers including recovery agents.⁸⁷

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

No loan shall be disbursed unless the lender has approved the recipient of the loan and all concerned participants have signed the loan contract.

The directions also provide guidelines regarding -

- i. The fund transfer mechanism
- ii. Submission of data to CICs
- iii. Grievance redressal framework
- iv. Technology framework

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”*.

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.

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

⁸⁷ Outsourcing of activities must adhere to Annex VI of the P2P Master Directions - https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11137#AN6

principal in case of default by a borrower and that the platform shall not provide any assurance for the recovery of loans.

P2P Master Directions also require participants to produce certificate with respect to Prudential Norms.

DISCLOSURE AND SUBMISSION OF CREDIT INFORMATION

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

Para 10 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.

Is there any interval for update of credit data by the platform?

The directions stipulate that the NBFC-P2P must update the credit data, relating to borrower transactions on the platform, 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.

Is it necessary for the platform to obtain consent for providing credit data to the CICs?

The P2P Lending Platform shall obtain consent from the participants for providing credit data to the CICs and para 10(2) of the directions directs the platform to include necessary consents in the agreement with the participants.

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.

How will NPAs be classified by a NBFC-P2P?

The RBI P2P Master 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”*.

How frequently does the platform have to update its NPAs?

Para 11(1)(iii)(d) of the RBI P2P Master Directions state that its portfolio performance including share of NPAs must be updated on a monthly basis and publicly disclose on its website.

In what format will the interest rate charged by the participants of the platform be displayed?

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

TRANSPARENCY REQUIREMENTS

How will the transparency be maintained between the participants?

For the purpose of matchmaking, the 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. The platform is also required to disclose to the borrower details of the lender including proposed amount, interest rate offered but is not required to disclose the personal identity and contact details of the lender.

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.

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

Operational Guidelines in the P2P Master Directions state that there must be Board approved policy setting out the rules for matching lenders with borrowers in an equitable and non-discriminatory manner.

Hence, the role of the platform is restricted to providing an unbiased choice to the lender of the details, borrowing needs and credit assessment of the borrowers and it is the lender who performs the selection based on such information provided.

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 permitted to not to be revealed to the borrower when the loan offer is made, however, at

the time of execution of the loan execution such opacity may stand in the way of validity of the contract .

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.

How will the interest rate be decided?

As per the P2P Master 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.

The P2P Master Directions also require the lender to disclose the interest rate at which he is willing to lenf.

Hence, 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.

TRANSFER OF FUNDS

When will the lender deposit the loan amount?

The P2P Master Directions do not provide specific directions as to when the lender needs to bring in the loan amount, however, para 9 of the said Directions provides the fund transfer mechanism that must be followed by P2P Lending Platforms, wherein it states that fund transfer between the participants shall be through escrow account mechanisms which will be operated by a bank promoted trustee. At least two escrow accounts, one for funds received from lenders and pending disbursal, and the other for collections from borrowers, shall be maintained.

It is recommended 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.

How will the transfer of funds take place?

Para 9 of the P2P Master Directions state that funds transfer between the participants and the platform must take place through escrow accounts mechanism, which will be operated by a bank promoted trustee. The platform must maintain at least 2 escrow accounts- one for funds received from lenders and awaiting disbursement, while the other for maintaining collections from borrowers.

Who appoints the trustee?

The P2P master Directions do not specify the appointing authority but requires that the trustee promoted by a bank. In its Review of the P2P Master Directions⁸⁸, the RBI has clarified that the escrow accounts to be operated by bank promoted trustee for transfer of funds need not be mandatorily maintained with the bank which has promoted the trustee.

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 directly from the participants or through the platform.

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.

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 mechanism⁸⁹ advised by RBI in the Directions. As per the mechanism advised by the RBI, instructions may be provided directly by the participants to the trustee operating the escrow account or via the platform.

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.

FAIR PRACTICE AND GRIEVANCE REDRESSAL

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

⁸⁸ <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11764&Mode=0>

⁸⁹ https://rbidocs.rbi.org.in/rdocs/content/pdfs/P2PMD04102017_A1.pdf

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. 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.

In the matter of recovery of loans, NBFC-P2P shall ensure that the staff are adequately trained to deal with the participants in an appropriate manner and shall not resort to harassment viz; persistently bothering the borrowers at odd hours, use of coercion for recovery of loans, etc.

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/ Nodal Officer/ Principal Nodal 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 RBI⁹⁰.

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.

INFORMATION TECHNOLOGY (IT) FRAMEWORK

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 conform with the IT framework prescribed for systematically important NBFC⁹¹ 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 fit, also prescribe technical specifications from time to time.

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

⁹⁰ The RBI has launched the Integrated Ombudsman Scheme 2021 whereby grievances may be logged with the RBI CMS portal - https://rbidocs.rbi.org.in/rdocs/content/pdfs/RBIOS2021_121121.pdf

⁹¹ Section A of Master Direction - Information Technology Framework for the NBFC Sector - https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10999

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.

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.

GOVERNANCE AND REPORTING

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

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 RBI 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.

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.

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.

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.

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.

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.

What are the Reporting Requirements specified by RBI?

Para 19(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.

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

Para 19(2) specifies that the aforementioned documents are to be submitted to the Regional Office within 15 days after the quarter to which they relate.

ANNEXURE II: SURVEY SUMMARY

Responses of the the survey carried out during 2020-21 are presented below -

	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 Yes

Source: Refer note⁹²

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 active⁹³ 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 INCLUDED IN 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?
- 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

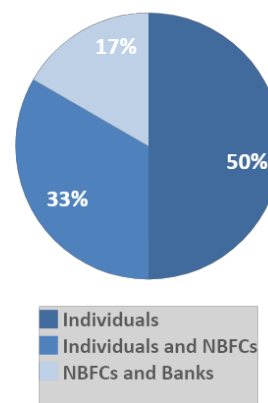
⁹²

<https://p2plendingsite.wordpress.com/2017/06/30/12-benchmarking-p2p-alternative-vs-mainstream-returns/>

⁹³ The survey was conducted in ***

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.

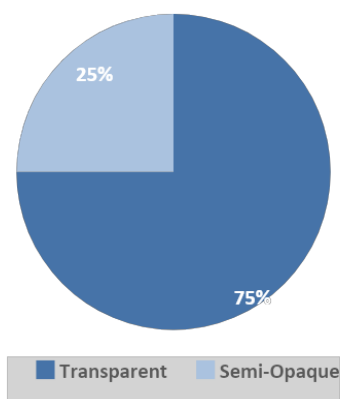
We also discovered that while platforms have several registrations from individuals and other body corporates, active lenders on the platform are only a small proportion of those registered. Among the active lenders, a substantial share is that of NBFCs and Banks.

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



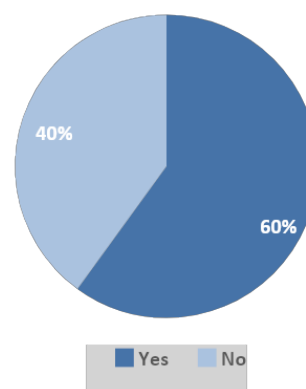
For various reasons and quite obvious ones, we understand that it most favourable for the platforms to create a transparent operating environment for the lenders and the borrowers.

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.

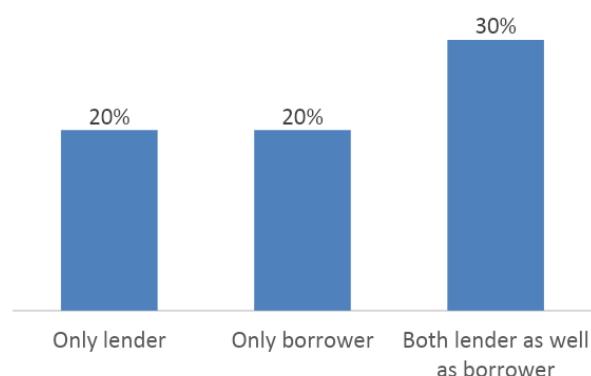
What is the rate of interest charged on these loans?

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.
