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P2P lending guidelines
A step towards sustainable alternative lending

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Salient features of the guidelines

On October 4, the Reserve Bank of India (RBI) issued directions for compliance by every company that carries on or intends to carry on the business of a peer-to-peer (P2P) lending platform.[1]

PwC discusses the key inferences and way forward for P2P lending business in India.

Need for clarity on applicability of the directions to P2P lending players

A fundamental issue that necessitates clarifications from RBI pertains to the definition of 'participant', as although the RBI defines a participant as 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', it remains to be seen whether digital lending platforms backed by institutional lenders will fall under the purview of the NBFC-P2P directions. Similarly, there is uncertainty around direct selling agencies performing services for institutional lenders, since the definition is wide enough to cover P2P lending entities carrying on business in a manner other than through online channels.

Boosting confidence in P2P lending by enhancing the transparency mandate

One of the primary challenges to the sustained growth of the alternative lending business was the adoption of limited and non-standardised disclosures of the parties, the underlying credit model, and the protection and usage of data. As per the directions, an NBFC-P2P is mandated to disclose all necessary and sufficient details of the correspondent parties, the credit score and details of the loan contract to borrowers and lenders. It is also required to disclose the methodology, methods of usage and protection of data, grievance redressal mechanisms, and portfolio performance of the platform periodically. This guideline will ensure fair lending and acceptable terms of loans and will

boost confidence of borrowers and lenders in the alternative lending model.

[1]. RBI/DNBR/2017-18/57 Master Directions - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017, October 4 2017. Retrieved from https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11137&Mode=0 (last accessed on 12 October 2017)

Salient features of the guidelines

Addressing concerns related to quality of credit risk assessment

Another major hindrance to the development of the P2P lending model in India was the lack of a comprehensive view of the risk profile of a borrower as data of loans availed of across firms was not available at a centralised location. The directions mandate that all NBFC-P2P platforms share all the necessary credit-related information to credit information companies (CIC) on a monthly basis. With a consolidated view of the history of the proposed borrower, the P2P lending platform will be able to price loans more efficiently. Parameters such as repayment behaviour, exposure and income details would be available uniformly for credit assessment.

Enhanced safety perception of a P2P lending platform through robust FRM and AML framework

One of the salient features of the directions is the requirement of an escrow account for a fund transfer between a lender and a borrower. The escrow account operated by a trustee promoted by the bank maintaining the escrow account eliminates any cash-based and/or direct fund transfer between the lender and the borrower and addresses the risk of money laundering. Due diligence of borrowers, capping of aggregate exposure as well as exposure to any one borrower for the lender and availability of aggregate loans for a single borrower will further minimise the misuse of the platform. A board-approved grievance redressal mechanism will further allay concerns about availing of a loan through the platform.

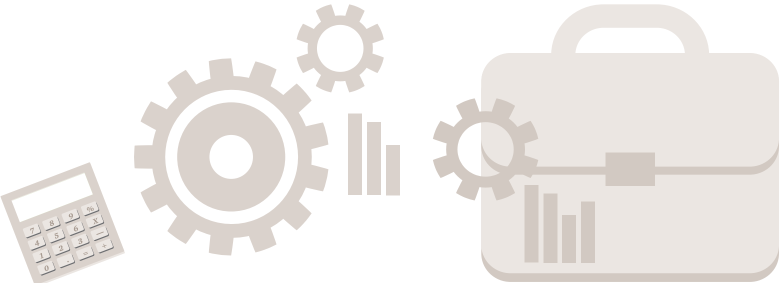
Encouraging use of modern technology

The directions encourage the establishment of online-only business models for P2P lending. This is a deviation from the mandate of setting up a brick-and-mortar offline presence, as envisaged in the consultation paper released in April 2016.[2] This move will allow aspirants to have a low-cost business model with low acquisition and servicing costs, which will make their businesses sustainable. It will also encourage them to offer better rates to borrowers.

2. RBI. (2016). Consultation paper on peer to peer lending. Retrieved from https://rbidocs.rbi.org.in/rdocs/content/pdfs/CPERR280416.pdf (last accessed on 12 October 2017)

Promoting a balanced approach

RBI has applied a differential regulatory framework for P2P lending platforms by categorising them as NBFC-P2P. They are not required to adhere to the stringent norms of a typical NBFC. This will assist P2P lending platforms in developing flexible models. The platforms have, however, been subjected to specific responsibilities such as collection of documentation, disclosure of performance of the portfolio and risk management, which will lead to the adoption of a responsible business development approach. The balanced approach extends to investors as well. While the cap limits may discourage a few lenders seeking big ticket size loans, the disclosures would encourage lenders seeking avenues to enhance their returns through greater risks, as the P2P platforms would be incentivised to ensure the efficacy of their credit models.



Way forward

In light of the formal regulatory status accorded to P2P lending players, PwC expects growing interest in this business from a large number of FinTech players and investors. Existing players will have to move quickly and apply for NBFC registration by 4 January 2018. The key success factor for P2P lending platforms is leveraging digital technologies to comply with the requirements without hampering the 'seamless user journey'. They must create customised products at attractive rates for individuals such as entrepreneurs, freelancers, the self-employed and those typically excluded by traditional lending firms due to lack of credit history. The platforms can develop their own innovative credit scoring models using alternative data points to continue to cater to a wider borrower base. This in turn will attract more lenders, with the possibility of more variety in investment returns.

As the guidelines are technology friendly, the platforms can collaborate with banks, e-commerce players, offline merchants, etc., through innovative application program interfaces (APIs) over the cloud to create a digital and risk profile of a customer and offer customised lending solutions over multiple channels such as mobile, web and agent/third-party assisted model.

The RBI directions are an important step towards creating a differentiated and sustainable lending model in India. While some of the operational requirements in the directions could cause teething problems, overall, they have the potential to significantly boost the financial inclusion objective and meet the credit demands of a number of underserved people in the country.

A higher number of P2P lending players offering innovative solutions in a regulated environment will significantly aid financial inclusion.

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