Promoting and regulating Fintech in Asia: case of peer to peer lending

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March 3, 2017

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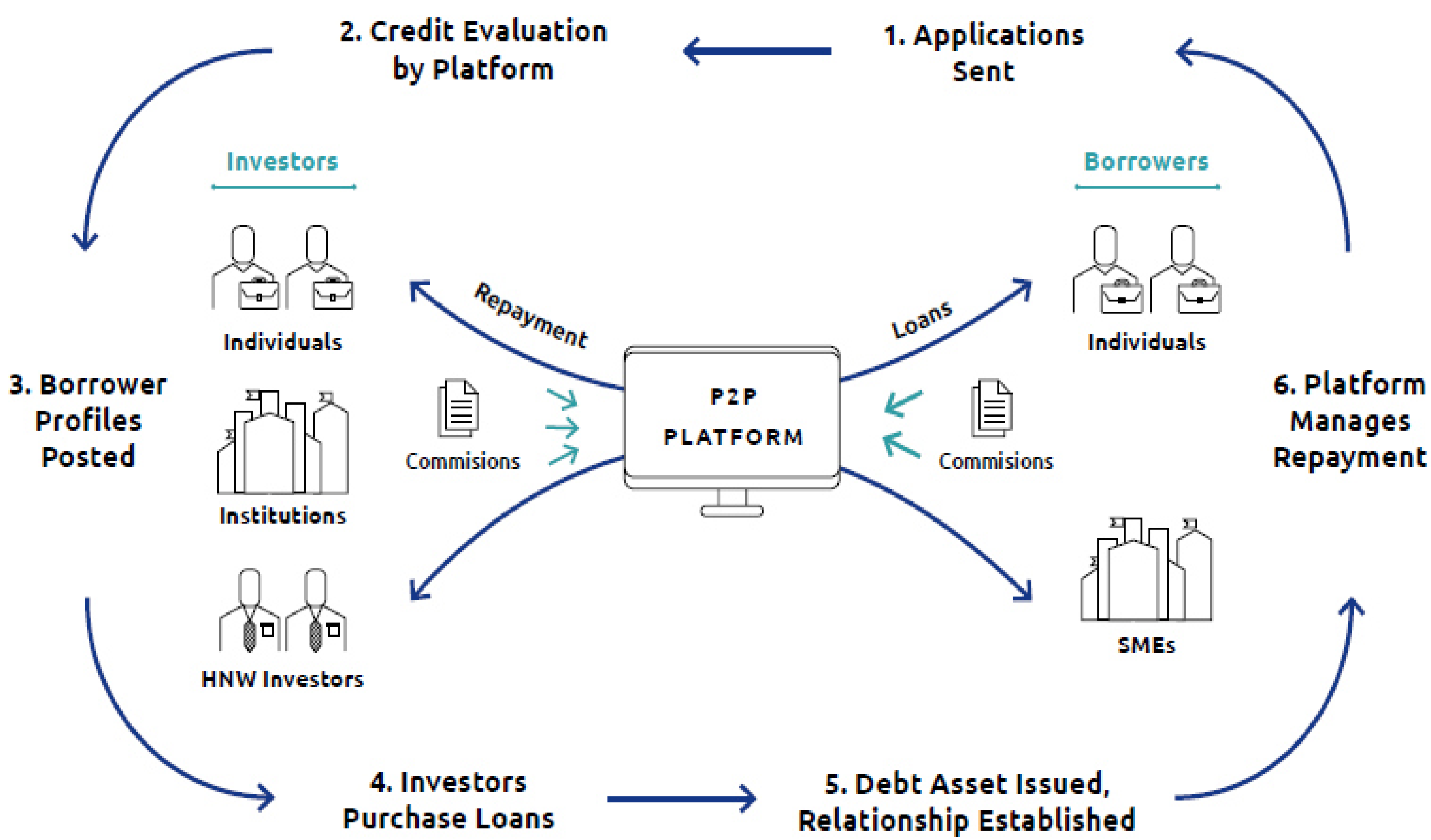
Overview of P2P lending

P2P lending is carried out directly between borrowers and lenders without intermediation of a traditional credit institution.

- Borrowers (personal or small businesses) request loans online, where their loan requests can be viewed as loan profiles
- Individuals and businesses can then “buy” or invest in pieces of these loans or whole loans through an online marketplace
- P2P companies organize the entire process from start to finish, screening loan applications, evaluating the risk of borrowers, providing the online marketplace for buying loans, and eventually overseeing repayments back to lenders. They make money by charging fees to both borrowers and lenders.
- No government guarantee.
- Network of partnerships
  - Banks or payment service providers help move money
  - Online analytic tools to track, analyze and manage loan investment for investors
  - Secondary market for loan sales
  - Third-party debt collection agencies

How P2P lending works?



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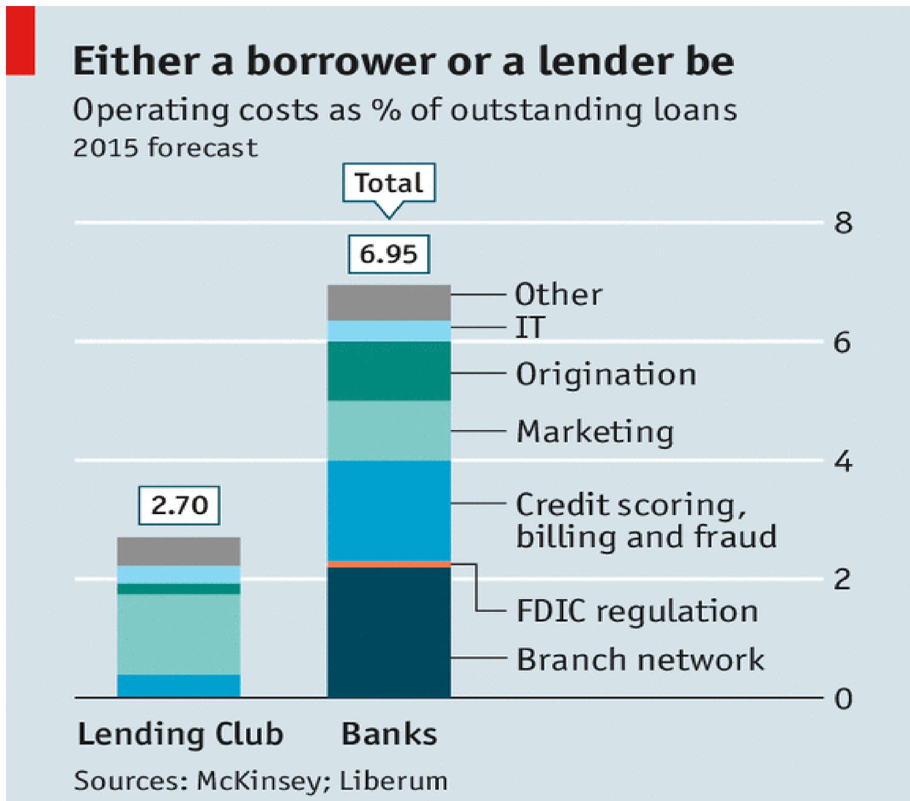
The Power of P2P lending

No need for physical branches, faster transaction processes, fewer staff, lower operation cost, higher rate of return

US Lending Club claims to have costs of only 270 basis points versus a typical bank's 695.



Three impacts of P2P lending

1. Create a unique asset class

- P2P lending allows investors to directly own many pieces of loans from many distinct borrowers.
- P2P lending caters to a wide array of investor interests while also serving unique borrower segments with low investment thredshold
    - “At the time the banks were offering 1 per cent returns on income and Zopa was offering 5 per cent, that’s what attracted me”.
    - “The nice thing about Zopa is that you can call the company up – it’s a website but there’s none of that ‘email us and we’ll get back to you’ nonsense”.

Three impacts of P2P lending

2. Advanced credit evaluation

- banks have primarily relied on credit scores and their own data for credit evaluation
- In the cases where credit scores are unavailable, P2P platforms can use big, digital data collected through mobile apps, online websites, utility bills, tax returns, and client purchase and payment histories to assess clients without having a prior relationship with them
- P2P companies also encourage borrowers to disclose their information on the platform

Three impacts of P2P lending

3. Extend financial inclusion

- The lightweight structure and lower starting capital costs have allowed P2P lending to spread to developing countries where the population of underserved groups is far greater
- Quite a few of Asian countries haven’t built out banking infrastructure, so there’s a massive opportunity for them to skip a generation, leapfrog, go online and adopt new forms of finance
- In cash-intensive economies such as Asia, a lot of person are deemed “unbanked” because they don’t possess a credit card, or even a bank account
- Fintech startups have come up with alternative credit systems to allow customers to bypass traditional financial intermediaries
    - eCredable gives consumers a letter grade based on their payment information that the company collects from the landlord, utility provider, insurance company or other vendors to verify timely payments.
    - Cignifi uses Big Data technology to deliver credit and marketing scores using mobile phone behavioral data.
    - SharedLending uses an algorithm that determines one’s credit worthiness based on five human characteristics: productivity, resilience, finance, health and education.

2. P2P lending in Asia

P2P lending in Asia

The roots of P2P lending lie in the UK and US and go back to 2005-06

- Zopa, Prosper, Lending Club and Ondeck

Over the years, Asia has overtaken the US, primarily led by China. In 2015, P2P lenders globally originated loans worth US$64bn, with China contributing more than half of the total.

- China – Lufax, Dianrong, Yirendai
  India – Faircent, Lenden Club, i2ifunding
  Southeast Asia – Funding Societies, Modalku
  Hong Kong – WeLab
  Japan – Maneo

P2P lending in Asia

Growth drivers for P2P lending in Asia

- Rapidly-developing and high-growth Asian economies with large but credit-worthy underbanked populations
- Huge funding gaps where banks are not able to lend
- The availability of a large pool of retail investors with excess cash
- Increasing internet and mobile phone penetration
- Fintech-led fast online processes that help reduce costs and overheads
- Support from regulators and government bodies towards inclusive financial growth

P2P lending in Asia

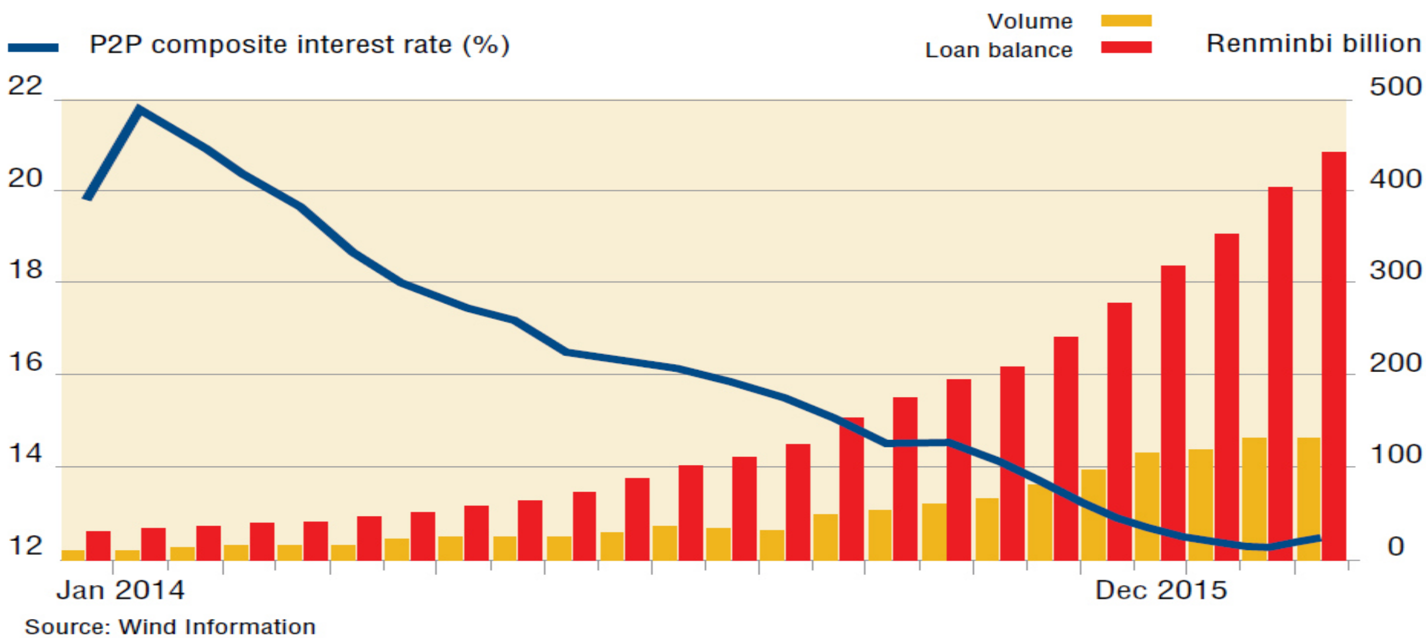
Recent developments

- use behavioural data from social media, acquire data through partnerships, and also use innovative technology-based credit scoring methods for giving out faster and lower-cost loans
  - Paipaidai in China which uses the online trading history of the borrower to underwrite loans
- the advent of cross-border P2P lending.
  - Crowdcredit funds borrowers in emerging markets including Europe and Latin America through retail investors based in Japan
- P2P segment has attracted a significant amount of venture capital (VC)
  - Lufax: Raised about US$19bn in their Series B round
  - Dianrong: Raised about US$1bn in their Series C round
  - WeLab: Raised U$160m in their Series B round
  - Funding Societies: Raised about US$7m in their Series A round

Challenges of P2P lending in Asia: lack of data availability, low internet penetration, manual processes and regulatory difficulties

P2P lending in China

The first Chinese P2P company, PPDai, was conceived in 2007. It initially provided micro-loans to small e-commerce ‘Taobao’ shops.



China now has the largest P2P lending market in the world. The balance of P2P lending totaled 816.2 billion yuan ($118 billion) at the end of 2016, over twice that of a year before. Transaction volume reached 2.063 trillion yuan, roughly 2.1 times the sum of the previous year.

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Growth of P2P lending in China

Internet finance quickly accelerated in 2011 due to several factors.

- China's middle class are adept with technology and willing to explore new investment opportunities
- Very credit-tight conditions. The biggest lenders in China are state-owned banks, which tend to favour lending to state-owned enterprises over lending to private firms. Almost 400 million Chinese adults are unbanked or considerably underbanked.
- Lack of investment channels and negative real interest rate
  - Returns from P2P lending is around 12-18%, three to five times higher than the bank deposit rate
- Lax regulation: online finance has been a channel through which regulators have allowed non-bank lending to grow
  - PBOC issued "Guiding Opinions on Advancing the Healthy Development of Internet Finance" on July 18, 2015
    - Positively acknowledge that internet finance has "improved the allocation of capital and advanced innovation."
    - Internet finance should "serve the real economy well."
    - Regulation will be "moderately loose" overall.

P2P lending models in China

Borrowers: the first generation of P2P platforms typically served migrant workers; now approximately two-thirds of P2P loans go to college-educated borrowers; P2P has become an important financing channel for consumption loans, and also many SMEs starved for credit (accounting for 20-40% of borrowers)

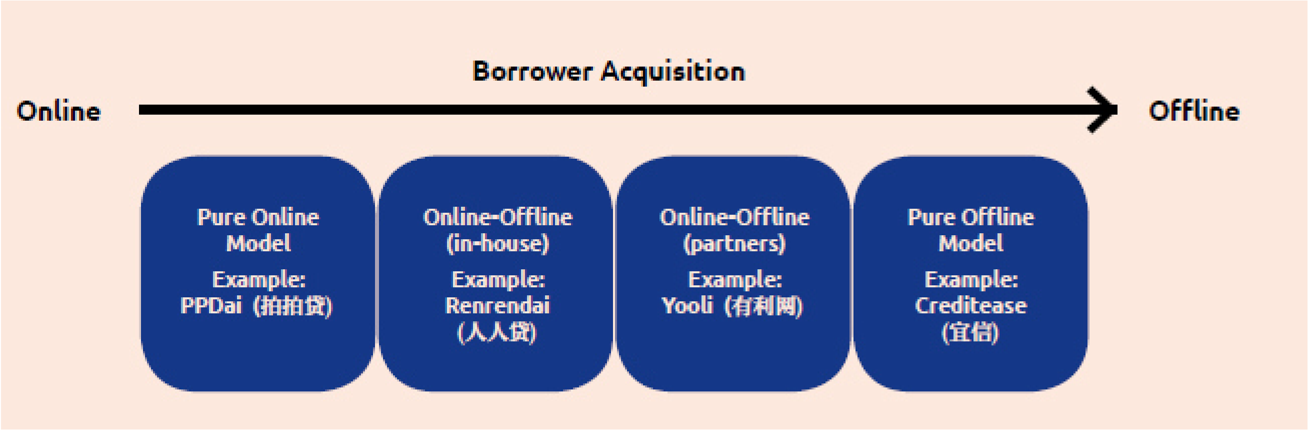
Investors: the majority are tech-savvy young professionals aged 30-50 because P2P investment offers an attractive yield compared to bank deposits while having lower investment thresholds

Geographically fragmented: the largest 100 platforms in China comprise of only about half to two-thirds the total market; investors tend to trust local brands; firms open P2P businesses by first leveraging their local distribution networks to source borrowers

P2P Lending models in China

Unlike in the US or UK, P2P platforms in China are almost uniformly less focused on technology.

- the majority leverage on existing distribution networks and use some combination of online tools and low-tech, offline means to facilitate lending
- many P2P companies in China employ huge teams across the country to market investment products and service loans, no different from traditional financial institutions



Chinese P2P lending model

Guarantees: a lot of Chinese P2P platforms make explicit promises that all of the principle or in some cases, both principle and interest will be repaid

Guarantee companies, a financial entity unique to China, help facilitate loan-making by promising to make good on repayments if borrowers default

- One-fourth of outstanding debt is backed by these companies
- They typically only charge around 3.5 percent fee for their service but can leverage their assets more than 10 times under current regulations
- Undercapitalized and shaky guarantee companies put the responsibility off of P2P companies on paper, but realistically, most guarantee companies would quickly fail if unexpected defaults would occur
- It also channels funds to industries, such as real estate that the government has tried to restrict

Chinese P2P lending model

Pooling Money**-**Because the demand for online products often exceeds the total amount loaned to borrowers, platforms often hold investor capital to invest as soon as more borrowers are sourced.

The pooling of capital is needed to offer competitive products and engineer simple mechanisms to mismatch loan maturities with investor payment plans

Some platforms have been accused of the Ponzi-scheme tactic. Hundreds were blacklisted by Dagong Global Credit Rating for similar concerns over transparency.

- Ezubao, once one of China's best-known new financial firms, instead of paying investors out of revenues from business projects, it was paying long-standing investors with the money deposited by new ones, meaning liabilities exceeded assets and the firm was permanently insolvent. On 31 Jan 2016, Ezubao had over 900,000 investors who had lost about 50 billion yuan ($7.6 billion). Protests about Ezubao have broken out in 34 cities.

- At the end of 2015, nearly a third of all Chinese P2P lenders (1,263 out of 3,858) had run into difficulties of halted operations, disputes, frozen withdrawals or boss running away (266 P2P bosses have fled over the past six months)

3. Regulating P2P lending

Regulating P2P lending Market

- Information asymmetry on P2P lending is likely to be more exaggerated than that in the traditional credit market
  - Borrowers and lenders are anonymous
  - No financial intermediation
- Results:
  - Investors need to screen creditworthiness of borrowers by aggregating information disclosed by borrowers
  - lending fraud, identity theft, money laundering, consumer privacy and data protection violations.

Regulation on P2P lending

US model:

- P2P platforms registered at Security Exchange Committee
- P2P platforms are required to disclose all information that may be material to an investor's decision
- SEC protects investors through disclosure requirements and antifraud provisions that can be used to hold companies liable for providing false or misleading information to investors

Regulations on P2P lending

- Indonesia
  - Foreigners can operate P2P lending platforms, but can only own 85 percent of the business.
  - Foreigners can only act as lenders
  - Minimum capital of roughly US$200,000
  - loans capped at US$150,000
  - No cap on interest rate
  - P2P platform owners are not allowed to access the capital. They receive commission only from transactions they've enabled. They're required to store the funds from lenders in a separate account to which they don't have access. It's the same for the reverse flow.

Regulation on P2P lending

On 24 August 2016, the Chinese government released the Interim Measures on Administration of the Business Activities of Peer-to-Peer Lending Information Intermediaries

- Define a P2P lending platform as an intermediary provider of online lending information
- platforms need to be registered as a unique P2P entity
- ban P2P companies from financing their own projects
- formal guarantees are prohibited
- there will be central regulation, but enforced by regulators at the local level
- capital requirements for registration will be required
- 3rd party institutions (namely big banks) will be required to hold investors' funds in escrow
- there will be a need for credit risk evaluation
- loan size capped at 200,000 RMB for an individual and 1 million for a company at the same platform
- Interest rate capped at 4 times of bank rate

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The future of P2P lending

New, Big Competition

- In recent years, many non-traditional lenders have integrated loan-making into their own business models to support existing clients
  - China's Alibaba provides loans to sellers using its e-commerce platforms
  - Paypal has provided loans based on a cash flow-based account of creditworthiness
  - More and more e-commerce platforms and payment services will follow the lead of Alibaba and Paypal in utilizing customer data to issue loans
  - To prevent major retailers from doing the same with their own customers or employees, P2P companies will have to convince businesses to lend through their platforms or risk being marginalized

Super-sized P2P Companies

- In countries with developed credit histories and financial markets, P2P firms will undergo a process of consolidation so that now large P2P companies will become industry behemoths

Thank you very much!