PEER-TO-PEER (P2P) LENDING AND RBI'S REGULATIONS

*Written by **Saloni Mittal***

3rd year BBA LLB Student, School of Law, Christ deemed to be University

BRIEF OVERVIEW

P2P lending is a crowd-funding model which is largely conducted online and acts as a common platform for investors who wish to invest money and act as lenders and for the borrowers who can borrow money. For the lenders it is beneficial as they tend to earn interest on their saving and for the borrowers it is beneficial as they can avail to the loans at a comparatively lower rate of interest. Borrowers are either individuals or small businesses. But unlike a traditional savings account, one can lose money if the borrower defaults. The government now claims that peer-to-peer lending (P2P) platforms would be treated as non-banking financial companies (NBFCs) and regulated by the Reserve Bank of India (RBI). P2P lending platforms are largely tech companies registered under the Companies Act. Once the borrowers and lenders register themselves on the website, due diligence is carried out by the platform and those found acceptable are allowed to participate in lending/borrowing activity. Some platforms provide several additional services like credit assessment, recovery etc. In most cases, the platform moderates the interaction between the borrower and the lender.

EXPECTATIONS FROM THE RBI REGULATIONS

The guidelines regulating the P2P platform shall ensure that the P2P platforms should be set up as a company. They would also ensure that the funds would directly move from the lenders bank account to the borrowers' bank account without the involvement of any middlemen. The firms should also be held liable for the confidentiality of all customer data. This guidelines would prohibit P2P firms from guaranteeing extraordinary or assured returns and urge the company's for setting up efficient business continuity plans. The directions from RBI would also ensure the setting up of proper grievance redressal mechanisms

REGULATING P2P LENDING PLATFORMS IN INDIA

On October 4th 2017 the RBI issued the master directions titled 'Master Directions - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017' which will regulate all the P2P lending platforms in India

ELIGIBILITY CRITERIA

- Only a company as defined in section 2(20) of the companies act will be permitted to undertake the business of peer-to-peer lending platform and no other non- banking entity will be permitted to do so.
- No NBFC-P2P shall commence or carry on the business of a Peer to Peer Lending Platform without obtaining a Certificate of Registration from the Bank. However any entity carrying on the business of a Peer-to-Peer Lending Platform as on the effective date of these directions, can continue to do so provided that it applies for registration as an NBFC-P2P to the Bank within 3 months from the date of the issuance of these guidelines.
- Every company seeking registration with the Bank as an NBFC-P2P shall have a net owned fund of not less than rupees twenty million or such higher amount as the Bank may specify.

PROCESS OF REGISTRATION

- All prospective NBFC-P2P shall make an application for registration to the Department of Non-Banking Regulation which is situated in Mumbai in a particular form which is specified by the bank.
- For the approval of the application, the bank requires certain conditions which have to be fulfilled. These conditions are regarding the technological soundness, capital structure and the management structure of the company and only if the bank is assured of these conditions will the bank grant a 'in-principle' approval for setting up of a Peer to Peer Lending Platform.

- The validity of the in-principle approval issued by the Bank will be twelve months from the date of granting such in-principle approval. Within the period of twelve months, the company shall put in place the technology platform, enter into all other legal documentations required.
- Finally when the bank is satisfied that the entity is ready to commence operation, it will grant the certificate of registration to the company to set up a P2P lending platform.

SCOPE OF ACTIVITIES

According to the master directions issued by the RBI the P2P firms shall only act as an intermediary providing an online marketplace or platform to the participants involved in Peer to Peer lending. They will however not be permitted to lend on their own or cross sell any product except for loan specific insurance products. The guidelines also do not permit the firm to engage in any international flow of funds. Further the NBFC-P2P shall be required to undertake credit assessment and risk profiling of the borrowers and disclose the same to their prospective lender.in case a borrower is unable to repay his dues the NBFC-P2P shall provide assistance in disbursement and repayments of loan amount. Lastly the NBFC-P2P shall ensure adherence to legal requirements applicable to the participants as prescribed under relevant laws.

PRUDENTIAL NORMS

Under the master directions all the companies must adhere to the following norms-

- The leverage ratio that is the total outstanding liabilities divided by their own funds of any company should not exceed 2. The requirement of a minimum leverage ratio not exceeding 2 presumably ensures that the NBFC P2P is likely to remain sustainable. Further, the leverage ratio would render the NBFC P2P incapable of borrowing indiscriminately so as to function within the leverage ratio.
- The aggregate exposure of a lender to all borrowers at any point of time, across all P2Ps and The aggregate loans taken by a borrower at any point of time, across all P2Ps shall be subject to a cap of Rs10,00,000

- The exposure of a single lender to the same borrower, across all P2Ps, shall not exceed Rs 50,000.
- The maturity of the loans shall not exceed 36 months.
- P2Ps shall obtain a certificate from the borrower or lender, as applicable, that the limits prescribed above are being adhered to.

TRANSPARENCY AND DISCLOSURE REQUIREMENTS

All NBFC-P2P shall be required to disclose information to 3 categories of people- its lenders, borrowers and to the public as well through its website.

- Lenders
  The NBFC-P2P will disclose all information regarding the borrower which will include his identity, the loan amount, interest rate and also the credit scoring of the borrower. They will also list out all the terms and conditions of the loan which include the fees and taxes and the likely returns to the lender. All this information is of vital importance to the lenders and thus should be adequately disclosed to them
- Borrowers
  To the borrowers the NBFC-P2P will take all measures to disclose information about the proposed amount the lender is willing to offer for sale and the interest rate offered, however no personal details of the lender will be disclosed which may include his contact details.
- Publicly through the website
  The NBFC-P2P will disclose all information regarding the measures taken to protect confidential information data and the grievance redressal mechanisms established. They will also be required to give an overview of their business model.

MERITS OF RBI GUIDELINES

- The RBI requirements would necessarily increase the compliance costs for an NBFC P2P; yet, at the same time, they would ensure that the business of P2P lending becomes transparent and stakeholders have complete access to basic information from each NBFC P2P.

- Transparency would also result in greater competition amongst the players, thereby benefitting the industry in general and the participants in particular.
- These guidelines would also ensure higher quality of credit through an efficient credit assessment.
- With these guidelines there would be greater legal accountability and loans could be granted at lower risk of defaults.

DEMERITS OF RBI GUIDELINES

- The RBI guidelines require the companies to have a minimum net owned fund of Rs 2 crores which has to be generated within a period of 3 months. However, some existing NBFC P2Ps may find it difficult to generate the minimum NOF within the mandated three month period.
- Raising finances for scaling up the operations may also be hindered since debt financing would have to be considered with the leverage ratio in check.
- Further, a three month period for existing entities to comply with, or draw out strategies to comply with the significant requirements of these Master Directions may also prove to be a clog in their regular operations.
- Lending platforms have been complaining that the maintenance of a leverage ratio of 2 does not make sense as they act as intermediaries and they do not hold any debt, Leverage ratio is a financial measurement that look at how much capital comes in the form of debt (loans) and equity. This might hurt their expansion plans.
- There is also a lack of clarity as to how the RBI is going to monitor these norms.

CONCLUSION

In my opinion the NBFC-P2P is providing a pool of opportunities to both the lenders and the borrowers to engage in business. The RBI has also laid a foundation for regulating these businesses by issuing the master directions, however there does not appear to be any strong implementation measures taken in this regard. Merely stating the direction will not ensure the efficient functioning of these businesses. On the whole, it can be commented that the RBI's publication of guidelines is a step in the right direction. The guidelines attempt to address a number of pain-points that both investors as well as borrowers have complained for long. Going forward, if these guidelines are implemented in the right spirit, the Indian P2P Lending industry will undoubtedly be benefited.

ARTICLES REFERRED

- What is P2P Lending and why has RBI decided to regulate it?
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- Mater Guidelines
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