

## P2P lending in China enters into a regulated era

On 24 August 2016, the China Banking Regulatory Commission (“**CBRC**”), the Ministry of Industry and Information Technology (“**MIIT**”), the Ministry of Public Security and the Cyber Administration of China (“**CAC**”) jointly released the *Interim Measures on Administration of the Business Activities of Peer-to-Peer Lending Information Intermediaries* (the “**Interim Measures**”). The Interim Measures comprise the first comprehensive legal framework specifically regulating peer-to-peer (“**P2P**”) lending activities in China, their detailed rules implementing the general principles listed in the 2015 *Guiding Opinions on Promoting the Sound Development of Internet Finance*. Most requirements under the Interim Measures mirror the contents of a consultation draft of the measures, which was published for public comment last December.

The Interim Measures are introduced against the backdrop of exponential growth in the P2P lending industry. That growth has been, in part, stimulated by China’s relatively loose regulation of internet finance to encourage creativity among market participants and assist small and micro start-ups to raise funds. However, several fraudulent platforms have been uncovered in the past two years, the dealings of which have inflicted huge financial losses on lenders and the wider public, and led to instances of social unrest in certain areas of China. The new measures are a welcome regulatory development to both better protect the interests of lenders and the general public as well as help the P2P industry to achieve more sustainable growth.

The Interim Measures provide a 12-month transitional period for existing P2P lending platforms to achieve compliance. In this alert, we will focus on the provisions of the Interim Measures that may have significant impact on industry players.

### **Nature of P2P lending and P2P lending platforms clarified**

The Interim Measures define P2P lending as direct lending and borrowing between individuals, corporate entities or other bodies through an internet platform. The nature of internet lending is clarified to be “private lending” which is, in short, the arrangement of finance between individuals and/or legal entities other than financial institutions.

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Under the new rules, an “internet lending information intermediary” – namely a P2P lending platform – means a validly-established company that specialises in acting as an intermediary provider of online lending information; in other words, it uses the internet as its main channel to provide borrowers and lenders with services consisting of information collection, publication and exchange; credit evaluation; and transaction matching.

## Operational requirements of P2P lending platforms

The Interim Measures impose the following key operational obligations on P2P lending platforms:

Requirement	Observation
<u>Filing requirements</u>	
<p>After obtaining its business licence:</p> <ul style="list-style-type: none"> <li>• Making a filing with the relevant local financial supervisory authorities.</li> <li>• Applying to the MIIT or other relevant telecommunications authority for a telecommunications business permit (ICP licence).</li> </ul>	<ul style="list-style-type: none"> <li>• No filing thresholds. The Interim Measures seek to regulate platforms through continuous supervision (see under “Regulatory supervision” below for more information).</li> <li>• Subject to issue of more detailed rules, the exact filing requirements are currently unclear. It is, however, indicated that local financial supervisory authorities will have authority to evaluate and categorise platforms, publishing their assessment results and platforms’ filing records.</li> </ul>
<u>Data management</u>	
<ul style="list-style-type: none"> <li>• Match finance counterparties in accordance with the contractual terms agreed with them.</li> <li>• Collect, analyse and release for public record information on direct lending and borrowing transactions.</li> <li>• Make various background checks on and review the risk credentials of transaction parties, the authenticity of information provided by borrowers, and the authenticity of proposed financing</li> </ul>	<ul style="list-style-type: none"> <li>• Domestically-collected information must be stored, processed and analysed in China and cannot be transmitted abroad. Foreign-invested platforms may need to refine their data management systems if they currently transfer data overseas.</li> <li>• More detailed implementing rules are expected to be issued on data privacy and technological standards to promote better compliance.</li> </ul>

projects.

- Protect borrowers' and lenders' information and maintain records of transaction information and the online communication logs of transaction counterparties for five years.
- Platforms are also required to comply with other relevant regulations on information security, anti-money laundering and counter-terrorist financing so will need to ensure that their legal and compliance functions are on-top of these fast-changing areas. (See our recent [alert](#) on cyber security for further information on this area.)

## Business scope

Prohibited from engaging in 13 categories of activity including:

- taking deposits from members of the public or creating asset pools;
- conducting offline promotion of financing projects;
- providing guarantees for borrowers (unless facilitated through a third party);
- selling wealth management products; and
- transferring debts by issuing asset-backed securities.
- Negative list approach adopted to regulate platforms' scope of business activities.
- Most restrictions reflect the nature of platforms as information intermediaries and seek to distinguish them from traditional lenders such as commercial banks and investment funds.
- Interestingly, the transfer of debts has not been completely prohibited, as a significant number of platforms are currently performing these services.

## Management of funds

- Must separate its own funds and funds of lenders and borrowers.
- Engage a qualified financial institution as a third-party banking custodian.
- Sign a funds custodian agreement with each borrower, lender, guarantor and banking custodian.
- CBRC issued a consultation draft of *Business Guidelines for P2P Fund Custodians* earlier this month, which set out more detailed rules on the regulation of the management of funds lent on P2P lending platforms. If these rules are enacted in their current form, requirements may prohibit smaller platforms from engaging custodians and, therefore, such platform operators may be barred from entering the P2P market in China.

## **Borrowing caps**

With the introduction of principles under the Interim Measures such as specific borrowing caps, the Chinese regulators set out a clear objective to limit P2P lending to small-size transactions that benefit the general public. Under the Interim Measures, the total amount that an individual can borrow on a single platform must not exceed RMB200,000, and RMB1 million on multiple platforms. The respective caps for a corporate entity are RMB 1 million and RMB 5 million. However, absent a centralised database which records all P2P lending information, it will be difficult for platforms to ascertain the aggregate outstanding debt of a borrower across multiple platforms.

The borrowing caps not only have the function of separating P2P lending from traditional bank lending, which is typically larger in amount and harder for individuals and small companies without sufficient collateral to access, they also help platforms to control risk. However, there is no cap on the total funding that a lender can provide on any one or more platforms which, to an extent, dilutes the risk controls imposed on platforms.

In addition, these borrowing caps will have an imminent practical implication for most existing P2P lending platforms. Platforms will be forced to recall, before the transitional period expires, loans from borrowers whose borrowings have exceeded the respective caps. Some borrowers may face liquidity problems and be unable to make these early repayments to the platforms, which may in turn affect platforms' compliance with the Interim Measures and increase the default rate among borrowers. In the long run, this may also compel existing P2P lending platforms to change their business models if they want to remain in the large-size loan markets (such as providing loans to small-to-medium-sized enterprises and housing mortgages).

## **Regulatory supervision**

The Interim Measures introduce a comprehensive regulatory framework for authorities at each level of government:

- Central MIIT, PSC and CAC: responsible for the regulation of P2P lending platforms' telecommunication services, internet security and the contents of online lending information, respectively.
- CBRC and its local counterparts: responsible for formulating and administering policies on the behavioural supervision of P2P lending platforms on a day-to-day basis. Key supervisory responsibilities will be to regulate the business activities and operational management of platforms through continuous supervision, for example by administering the registration of new lending products and on-going information disclosure.
- Finance office of provincial governments: responsible for the institutional supervision of platforms, focussing on platforms' filing and registration compliance.

## **Conclusion**

Long awaited by the market, the Interim Measures are both in line with China's banking regulatory policy and should help individuals and small and micro enterprises which are thirsty for capital to access funding.

For P2P platform operators, requirements such as engaging third party banking custodians and imposing borrowing caps will increase their compliance costs and squeeze their profit margins. A large number of existing platforms will likely have to change their business models or cease operation all together.

There will no doubt be a reshuffling and consolidation of market players but, in the long run, the Interim Measures should help to ensure a healthier market. Operators that understand and are able to efficiently navigate the new regime should be in a position to exploit opportunities in a P2P lending industry, which will hopefully be encouraged to enter a new period of sustainable growth in China.

## Reference:

**Regulations:** [Interim Measures on Administration of the Business Activities of Peer-to-Peer Lending Information Intermediaries](#) (网络借贷信息中介机构业务活动管理暂行办法), effective from 17 August 2016

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