The much anticipated directions on peer-to-peer lending were notified by the Reserve Bank of India (RBI) on 4 October 2017 to regulate the activities of a non-banking financial company (NBFC) engaged as an intermediary and connecting companies seeking to borrow with those willing to lend (P2P Guidelines) through its online platform. The P2P Guidelines came close on heels of the notification by the RBI on 18 September 2017 that conferred NBFC status to any company carrying out the business of peer-to-peer lending (P2P Lending), to bring these platforms under the supervision of RBI. The P2P Guidelines formalise the regulatory framework applicable to P2P Lending and provide legal validity and recognition to this rapidly growing sector that was previously unregulated.

Key Features

The key highlights of the P2P Guidelines are as follows:

- **Eligibility Criteria and Registration Requirements:** The P2P Guidelines permit only an entity incorporated as a company to carry out P2P Lending and require all NBFCs intending to set-up a P2P Lending platform (P2P Platforms) to obtain a registration from the RBI to carry out such lending. One of the key eligibility criteria is that the applicant should have net-owned fund of not less than INR 2 crores. Existing P2P Lending companies which were operating prior to the commencement of the P2P Guidelines have been provided a three-month window to obtain the certificate of registration (CoR) from the date of the P2P Guidelines. The existing P2P Lending platforms have been allowed to continue their operations until the rejection of the CoR by the RBI. As far as new entrants are concerned, RBI will grant an in-principle approval with a validity of twelve months to set up the P2P Lending business, following which, the RBI may grant a CoR on being satisfied that the P2P Platform has put in place the technological platform, entered into legal documentation and complied with the provisions of the P2P Guidelines.

- **Qualifications for obtaining a CoR:** The P2P Guidelines outline a broad set of conditions that would be considered by the RBI prior to registering a P2P Platform. The applicant should, *inter alia*, ensure that:
  - the company is incorporated in India and possesses the necessary technological, entrepreneurial and managerial resources to offer P2P Lending to participants;
it has adequate capital structure to undertake the business of P2P Lending,

the promoters and directors of the company are fit and proper and the general character of the management of the company is not prejudicial to public interest; and

the company has submitted a viable business plan for conducting the business of P2P Lending platform and has implemented, a robust and secure information technology system to facilitate P2P Lending on the P2P Platform.

**Expansive Obligations:** The P2P Guidelines set out some of the key responsibilities which are required to be assumed by the P2P Platform in connection with its role as a financial intermediary. It requires the P2P Platform to:

- conduct satisfactory due diligence on prospective participants;
- undertake credit assessment and risk profiling of prospective borrowers and disclose such findings to the lenders;
- store and process all data relating to its activities on hardware located in India;
- obtain prior and express consent of the participant to access its credit information, and
- ensure that the lenders and the borrowers have entered into adequate transaction documentation in connection with the P2P Lending and offer recovery assistance to lenders with respect to loans that originated on the platform.

**Restrictions:** While discharging its role as an intermediary, the P2P Platform provider has been restricted from undertaking any of the following actions:

- raising any deposit or lending on its own;
- providing or arranging any credit enhancement or guarantee;
- facilitating or permitting any secured lending linked to its platform;
- holding on its own balance sheet, funds received from lenders for lending to borrowers or from borrowers towards repayment of loans to lenders or such funds, as specifically required to be maintained under an escrow-trust arrangement. However, these restrictions would not apply to deployment of any investible funds by such a provider in instruments permitted by RBI; or
- from cross-selling any product save for loan insurance policies.

Interestingly, a P2P Platform cannot permit any international flow of funds or store or process data relating to its activities and participants on hardware located outside India.

**Prudential Norms:** RBI has imposed a range of strict prudential norms that are required to be complied by a P2P Platform provider. These norms include the requirement to:
• maintain a leverage ratio, where the proportion of the total liabilities owed by the NFBC-P2P shall not be more than two times its net-owned funds;

• ensure that the exposure of a lender to all borrowers at any point of time and the aggregate loans availed by a borrower, in both cases across all P2P Lending platforms, do not exceed INR 10 lakhs, while the exposure of a single lender to the same borrower, across all P2P Lending platforms, has been restricted to INR 50,000;

• ensure that the maturity of the loan do not exceed more thirty-six months.

Mechanism for Transfer of Funds: To ensure seamless management of funds, the P2P Guidelines require the P2P Platform provider to maintain at least two escrow accounts – one, for receiving the funds from the lenders, pending disbursal and the other, for collection of amounts from the borrowers, towards debt servicing. These accounts are required to be operated by a trustee, appointed by the escrow bank, maintaining the escrow account. It is pertinent to note that the P2P Guidelines expressly restrict any cash transfer between participants and prescribes that all fund transfers are required to be made through banking channels. This will help RBI keep a check on money-laundering and compliance issues from an exchange control perspective.

Capital Issue and Change in Control Restrictions: In a bid to closely monitor investments in these platforms, the P2P Guidelines stipulate several restrictions on the transfer of controlling interest in the P2P Platform that are typically applicable to NBFCs. The P2P Guidelines provide that a prior written approval of RBI is required to be obtained for:

• allotment of any shares that may result in the overall shareholding of an individual or group to exceed twenty-six percent in the P2P Platform,

• effecting any takeover or acquisition of control of a P2P Platform, that may or may not result in a change in management,

• effecting any change in the shareholding of a P2P Platform, that may result in the acquisition by or transfer to, any entity, of twenty-six percent or more of the paid-up equity capital of the P2P Platform;

• implementing any change in the management of the P2P Platform, that may result in a change in more than thirty percent of the directors, excluding independent directors; or

• any change in shareholding that may provide a right to the incoming shareholder to nominate a director.

Separately, a public notice of at least thirty days is required to be provided to the RBI prior to effecting the sale, transfer of the ownership by sale of share or transfer of control of a P2P Platform.

Other Requirements: To ensure transparency in P2P Lending transactions, the P2P Guidelines stipulate that all P2P Platforms are required to maintain updated credit information data and submit such information to the credit information companies, make certain disclosures to the lenders and borrowers and submit quarterly reportings to the RBI on the amount of loans disbursed and the funds held in the escrow accounts, on the maintenance of leverage ratio and on the grievances that are outstanding and disposed-off. The P2P Guidelines also stipulate the compliance of 'fit and proper criteria' vis-à-vis the directors of the P2P Platform and require the
P2P Platforms to adopt a ‘fair practices code’ and a grievance redressal policy, for its operations.

Comment

The P2P Guidelines have been modelled to establish a simplified regulatory framework and regime for stakeholders involved in P2P Lending and offers several positives. Some of its provisions, including the net-owned fund requirement and the specified roles and obligations of the P2P Platform, have been prescribed to ensure that only serious players are interested in utilising its provisions and adopt a precautionary approach.

While the new regime will undoubtedly open-up opportunities for a wider set of players to participate in P2P Lending, some of the following aspects may be potential road-blocks deterring the healthy growth and development of the market:

- though the P2P Lending industry is in its nascent stage, the exposure of INR 10 lakhs for borrowers and lenders willing to participate in P2P Lending is significantly low. These thresholds may dissuade high net-worth individuals or interested borrowers from participating in P2P Lending, thereby limiting its growth and objective of achieving financial inclusion. Separately, RBI could have possibly introduced caps on interest rates charged by the lenders on the platform to better protect the interests of borrowers;

- while the P2P Guidelines require a P2P Platform to provide recovery assistance, the RBI could have provided more clarity on the role of a platform, in assisting lenders to recover their loans. Since the P2P Platforms may essentially comprise of financial technology start-ups, these entities may have limited capacity or experience to provide specialised loan recovery assistance services;

- since the P2P Platforms are not lending out of their books and merely operating as a platform provider, fixing a leverage ratio of two times requires them to arrange for funds, either through equity or otherwise, to meet this pre-condition. This obligation, coupled with the existing restrictions on transfer of shareholding, may prove to be extremely onerous for smooth functioning of the P2P Platforms;

- lastly, since the transactions would be operated on a digital platform, the requirement to route fund transfers through an escrow account maintained by a trustee, may be an operational challenge for banks that may eventually escalate transactional costs and delay implementation timelines.

While it presents significant challenges, the P2P Guidelines by the RBI indicate a willingness to adopt a more hands-on approach to regulate online lending platforms and aid the domains growth. In our view, the P2P Guidelines would go a long way in steering the country’s social lending market, provide a fillip to P2P Lending and present significant opportunities to interested market-players in the years to come.

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