

**Feedback on Regulations:
NBFC – Peer to Peer Lending
Platform (Reserve Bank)
Directions, 2017**

Discussion Document

16th November, 2017

The Digital Lenders' Association of India (“DLAI”) is appreciative of the RBI releasing regulations on Peer to Peer Lending NBFCs. It is a positive step in regulating such business models, that are addressing the funding needs of the underserved Indian market, and creating a new asset class in a new and innovative way. The guidelines will ensure stability, reliability, safety of funds and create vigilance among players. P2P Lending is a nascent industry and a light touch and least disruptive approach can nudge the sector in the right direction. In this regard, based on feedback from several industry participants on the Master Direction, we, place before you a compilation of the key recommendations and clarifications.

1. Definition of Participant:

Regulation: *“Participant” means 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*

Issue: Defining “participant” will provide clarity in operations. The term ‘person’ referred in the definition of “participant” has not been defined under the directions nor is it defined under the Reserve Bank of India Act, 1934 and the Companies Act, 2013. Would Individuals, Corporates, Banks, NBFCs, HUF, family offices, institutional lenders come under the definition of ‘a person’?

Recommendation: The purpose of bringing P2P platforms under the NBFC umbrella is to regulate it and protect the lenders and borrowers. Banks and NBFCs are already regulated and understand the risks associated with lending on the platform. We recommend that such Banks and NBFCs should not fall under the purview of the NBFC-P2P regulations. Large corporates and institutions, likewise, have large portfolios of investments and appreciate the related risks. Hence these corporates and institutions, which are already regulated by the Companies Act 2013, should also not fall under the purview of the NBFC-P2P regulations. Platforms which cater to individual lenders need to be regulated so that the interests of the individuals are protected. We therefore request RBI to consider limiting the lender protection norms to individual lenders.

2. Prudential Norms – Caps on Lender and borrowers

Regulation: *(2) The aggregate exposure of a lender to all borrowers at any point of time, across all P2Ps, shall be subject to a cap of INR 10,00,000/-. (3) The aggregate loans taken by a borrower at any point of time, across all P2Ps, shall be subject to a cap of INR 10,00,000/-. (4) The exposure of a single lender to the same borrower, across all P2Ps, shall not exceed INR 50,000/-.*

Issue: Cap limits are too low. The guidelines have stipulated these caps as a measure of investor protection for a new asset class. However, the present caps will nudge the platform disproportionately towards small and inexperienced lenders and expose them to the risks associated with a new asset class. This will defeat the spirit of investor protection, an important objective of the guidelines.

Furthermore, the cap on lending will lead to a natural exclusion of experienced investors such as high net worth individuals (HNIs) who both understand and have the ability to absorb the risks of investing in a new asset class. HNIs would not be interested in low values of investments as the cost of managing such investments would be disproportionately high.

As currently there are no caps on borrowers who borrow from private money lenders or from money lending business, putting caps would be contrary to the RBI's objective of moving informal lending business to formal channels. The core purpose of the NBFC-P2P guidelines is to extend access to formal credit and achieve greater financial inclusion, and limiting the P2P platform in these ways can limit these goals.

Recommendation:

- 1) Lender Cap:** As mentioned above, the caps will result in the exclusion of experienced/accredited investors and encourage platforms to aggressively focus on inexperienced retail investors. Not only will this affect the growth of P2P industry, it will also expose the retail investors to a new asset class, whereas HNIs would be excluded from the platform. HNIs who invest between INR 25 lakhs – INR 10 cr, have the experience and risk appetite for new investment products. They have the ability to conduct due diligence and provide consistent cash flow to the platform which helps in keeping interest rates low. We recommend that instead of absolute caps, the lender cap should be fixed at 25% of Net Worth of the lender.
- 2) Borrower Cap:** Borrowing caps should be linked to categorization of borrowers as opposed to a uniform cap that does not factor the credit needs and creditworthiness of different categories of borrowers. P2P platforms today are used by a diverse group of borrowers e.g. Individuals and MSMEs with average loan size varying between 1 lakh – 1 cr+ across platforms. We recommend the following borrower categorization that can be considered:

	Borrower Category	Borrowing Limits (Individual)
1.	Personal Loans (consumption oriented)	10 lakhs
2.	Unsecured Business Loans (working capital)	1 cr

- 3) Exposure of single lender to borrower:** While capping of loans to a borrower from a single lender is a welcome move to encourage diversification, absolute caps will discourage MSMEs from the platform. The waiting time for loan disbursements will increase significantly and filing Tax Deducted at Source (TDS) for too many lenders will result in additional paperwork for the borrower. We recommend that instead of absolute caps, the limit can be defined at two levels:
 - 25% of total loans taken by the borrower
 - 5% of the portfolio of lender

This will ensure an ideal balance of diversification as well as simplification of paperwork for the borrowers.

4) Monitoring: We would request RBI to comment on systems required to monitor compliance with individual and more specifically aggregate limits across platforms.

3. Scope of activities – Credit Guarantees

Regulation: *(1) An NBFC-P2P shall- (i) act as an intermediary providing an online marketplace or platform to the participants involved in Peer to Peer lending; (ii) not raise deposits as defined by or under Section 45I(bb) of the Act or the Companies Act, 2013; (iii) not lend on its own; (iv) not provide or arrange any credit enhancement or credit guarantee;*

Issue: P2P Lending is a small and nascent industry which needs support through credit guarantees or credit enhancements.

Recommendation: Credit enhancements play the role of catalysing growth of nascent industries by reducing risks for the lenders and reducing costs for the borrowers. Historically enhancements have been provided to encourage flow of credit to underfunded segments like microfinance, MSMEs and infrastructure sectors.

Example: Mudra provides credit guarantees on loans. As per MUDRA “The guarantee product is one of the key interventions with the objective of bringing down the cost of funds for the end beneficiary to improve its creditworthiness”. Additionally, the Ministry of MSMEs and SIDBI, together provide first loss or second loss guarantee through Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE), to create a deeper pool of lenders and to bring down interest rates for borrowers.

While RBI permits credit enhancements/guarantees to be given to institutional lenders, there is no reason why new FinTech companies such as Peer to Peer Lending Platforms should not be allowed to arrange credit guarantees. We request RBI to consider permitting P2P platforms to arrange credit enhancements from other RBI regulated entities provided those entities meet their capital adequacy requirements as per RBI regulations. Without it, the platforms will not be able to achieve scale or lender confidence.

4. Fund Transfer Mechanism

Regulation: *Fund transfer between the participants on the Peer to Peer Lending Platform shall be through escrow account mechanisms which will be operated by a trustee. At least two escrow accounts, one for funds received from lenders and pending disbursement, and the other for collections from borrowers, shall be maintained. The trustee shall mandatorily be promoted by the bank maintaining the escrow accounts. All fund transfers shall be through and from bank accounts and cash transaction is strictly prohibited.*

Issue: Requirement of a trustee will increase costs for the platform and ultimately for the borrower. It would also impede the speed of processing, which is an important differentiator for P2P Lending Platforms. Restriction to bank promoted trustee could create a monopolistic situation, which would not be favourable.

Recommendation: For escrow transactions to be approved by the trustee would delay the processing time. However, if the RBI believes that a trustee is required, then we request the RBI to consider not limiting the trustee to the banking group and allowing P2P platforms to use other SEBI registered trustees as well. Further, we believe that a nodal/escrow bank can suffice the requirement of segregating funds.

5. Transparency and Disclosure Requirements

Regulation: (i) to the lender (a) details about the borrower/s including personal identity, required amount, interest rate sought and credit score as arrived by the NBFC-P2P. (b) details about all the terms and conditions of the loan, including likely return, fees and taxes;

Issue: Revealing confidential details of the borrower to all potential lenders could breach borrower privacy. Indiscriminate sharing of borrower information may lead to theft of data and harassment of borrowers. This would make borrowers reluctant to share information with P2P platforms thus affecting the growth of the platform.

From the perspective of a P2P platform, detailed disclosure of borrower information could lead to predatory lending by competitors. Most P2P platforms have proprietary credit rating mechanism with varying levels of success in lead generation and conversion. With the public disclosure of all such information, theft of leads can become a serious industry issue.

Recommendation: Detailed disclosure of borrower information, prior to matching with specific lender(s), may lead to breach of borrower privacy and theft of leads of P2P platforms, thus affecting the overall growth of the platform. We request the RBI, to consider putting in place disclosure requirements, such that any disclosure of personally identifiable information takes place once the lender and borrower requirements have been matched by the P2P platform and the concerned lender and borrower have agreed in-principle to enter into a loan agreement. Further it must also be noted that PAN details of lenders may be needed by borrowers to deduct TDS and lender details would need to be shared with the borrower.

6. Grandfathering

Regulation: (iv) not provide or arrange any credit enhancement or credit guarantee;

(2) The aggregate exposure of a lender to all borrowers at any point of time, across all P2Ps, shall be subject to a cap of INR 10,00,000/-. (3) The aggregate loans taken by a borrower at any point of time, across all P2Ps, shall be subject to a cap of INR 10,00,000/-. (4) The exposure of a single lender to the same borrower, across all P2Ps, shall not exceed INR 50,000/-.

Issue: We need clarity on whether existing credit enhancement or credit guarantee schemes as well as present loans which do not comply with the cap as laid down in the regulations will be allowed to be “grandfathered”.

Recommendation: We request the RBI to issue a clarification on grandfathering of existing loans (which have already been disbursed) that may not comply with the limits and restrictions on security and credit enhancements as set by the Master Direction. We request that participants may be given a time period of 18 months to ensure all existing loans are fully compliant. Further, we agree that roll-over of any such non-compliant loans should not be permitted.

7. **Clarification on Definition of NBFC-P2P:**

Regulation: *“Peer to Peer Lending Platform” means an intermediary providing the services of loan facilitation via online medium or otherwise, to the participants as defined at Item (iv) of sub-paragraph (1) of paragraph 4 of these directions*

Issue 1:

We request clarity from the RBI on whether Direct Selling Agents (“DSAs”) that provide loan facilitation services to RBI registered institutional lenders such as Banks/NBFCs will fall under the NBFC-P2P regulations. Also, will entities that provide referral services and facilitate data pursuant to a contract with Institutional lenders fall under the above regulations?

Recommendation: We request the RBI to consider keeping such entities outside the purview of the NBFC-P2P regulations as these entities act merely in the capacity of a lead generator. Furthermore, lead generation is not the primary business of these entities.

Issue 2:

We would also request clarity from the RBI on whether the co-lending/loan syndication business of existing NBFCs will fall under the purview of the NBFC-P2P regulations. Many NBFCs originate loans from their balance sheet while syndicating a portion of a given loan to a third part co-lender. These co-lenders could include:

- i) Other Bank/NBFCs
- ii) Companies and HNIs lending from own funds

The loan structures are similar to consortium lending where NBFCs would participate from its balance sheet in all loans and for the balance loan amount undertake the role of a lead arranger through a privately placed syndication model.

Recommendation: As the loan syndication/co-lending business of NBFCs is already regulated under current norms and does not fall under the definition of “intermediation”, by virtue of the respective NBFC being a co-lender in each syndicated loan, we request the RBI to consider keeping the loan syndication business of NBFCs outside the purview of the NBFC -P2P regulations. Furthermore, the lenders in such transactions are privately syndicated through offline means unlike the online (public) matching of lender & borrowers under the NBFC P2P platforms.

As per RBI’s Consultation Paper on Peer to Peer Lending released in April 2016, *“P2P lending promotes alternative forms of finance, where formal finance is unable to reach*

and also has the potential to soften the lending rates as a result of lower operational costs and enhanced competition with the traditional lending channels. Therefore, the importance of these methods of financing needs to be acknowledged.” Further, RBI also acknowledges that Regulations perceived to be as too stringent, may stifle the growth of an innovative, efficient and accessible avenue for borrowers who either do not have access to formal financial channels or are denied loans by them.

This nascent industry had envisaged a light touch approach to P2P regulations which would be as less disruptive as possible to the existing industry. While the present regulations introduced is a positive step in promoting unsecured lending in the underserved Indian market, we, humbly, request the RBI to consider the above feedback from several industry participants. Furthermore, given the proposed regulations we believe that the timelines for application are too short and would request for an increase in the deadline for registration by 3-6 months to provide P2P Lending Platforms adequate time to comply with all the requirements.