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The rise of peer-to-peer lending in China:

An overview and survey case study

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China's peer-to-peer lending sector has emerged as the largest and most dynamic online alternative finance sector in the world. This report explores the emergence, characteristics and evolving policy environment of peer-to-peer lending in China and presents detailed findings from a survey of borrowers and lenders using China's first online direct peer-to-peer lending provider, Paipaidai.

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1. Executive summary

China's peer-to-peer lending market has become the largest in the world.

China's peer-to-peer lending market has become the largest in the world. The rapid growth of online peer-to-peer lending in China has been driven by the supply of funds from retail investors and by the demand for access to finance from individuals and from the owners of small and micro businesses. By applying innovations in alternative finance, peer-to-peer lending in China is creating new channels of credit information and increasing access to finance. Over half the borrowers from peer-to-peer lending providers who were surveyed for this report said they had no previous history of borrowing from traditional financial institutions, credit societies or other entities. Half the borrowers surveyed also said that their main reason for borrowing was to 'accumulate credit worthiness'. China's government has supported the continued growth of 'internet finance', including peer-to-peer lending and equity crowdfunding, while introducing 'moderately loose regulatory policies' (PBOC 2015a).

SIZE AND COMPOSITION OF LENDING

While as yet there is no verifiable data on the volume of peer-to-peer lending in China, by the end of 2015 it could be as high as US$20bn–40bn.[1] Retail investors are the primary funding source for peer-to-peer lending in China. The present research suggests that business borrowers, who are mostly owners of small or micro businesses, and some owners of medium-sized enterprises, could make up between 20% and 40% of peer-to-peer lending borrowers in China. This indicates a much higher share of peer-to-peer business lending in China than is the case in developed markets, which have been dominated by peer-to-peer consumer lending.[2]

CREDIT ENVIRONMENT AND DIVERSE PROVIDER MODELS

China's credit and banking environment is also quite different to that in developed countries and this has contributed to a wider set of peer-to-peer lending provider models in China than in other countries. One reason is the diverse origins of peer-to-peer lending providers in China. Although there are perhaps a minority of dedicated online technology providers, a large number of hybrid wealth-management companies and informal banks have entered the sector. These tend to use more conventional credit allocation processes. At the same time, because of the relative lack of available credit information, most direct peer-to-peer lending platforms in China also tend to rely much more on offline processes.

SURVEY FINDINGS

This report also presents findings from the ACCA's own detailed survey of 935 borrowers and lenders from China's first online direct peer-to-peer lending company, Paipaidai. Paipaidai started offering unsecured online peer-to-peer micro-loans in 2007, initially to small e-commerce 'TaoBao' shops. By 2015, Paipaidai claimed over 1,200,000 active members, i.e. borrowers and lenders. According to Paipaidai's founders, in the year to mid-2015, 42% of its borrowers were business borrowers and 58% were personal borrowers.

INDIVIDUAL BORROWER SURVEY RESPONSES

The demand for easier access to credit has been a key reason for the rapid growth of peer-to-peer lending in China. According to the survey findings, for example, of those respondents borrowing through Paipaidai:

- 87% selected the "low borrowing threshold and easy borrower audit process" as their main reason for borrowing through a peer-to-peer lending provider such as Paipaidai
- 56% said that they had no previous borrowing history from other financial institutions such as a traditional banks or credit societies
- 51% said that their main reason for borrowing funds from a peer-to-peer lending provider such as Paipaidai was 'to accumulate credit worthiness'.

This last finding, about borrower motives, suggests that borrowers' demand for more favourable access to credit mitigates some of the risk of default from unsecured lending. Online peer-to-peer lending creates new forms of information transparency and with it incentives for borrowers to meet their repayments in order to secure a positive online credit history.

1 According to data published by WangDaiZhiJia (网贷之家), an online news site covering the peer-to-peer sector, the total transaction size of peer-to-peer lending in China at the end of 2014 was almost RMB253bn (about US$40bn). Authors' calculations based on data from www.wangdaizhijia.com

2 See Wardrop et al. (2015: 17) for data on peer-to-peer business lending in the UK and Europe.

57%

of individual lender respondents to the survey said they usually bid for loans with interest rates in the 12% to 18% range.

INDIVIDUAL INVESTOR RESPONSES

The supply of funds from individual retail investors is a key reason for the growth of peer-to-peer lending in China. By lending through peer-to-peer providers, investors have been able to get returns three to five times higher than the bank deposit rate. Most individual lender respondents to the survey (57%) said they usually bid for loans with interest rates in the 12% to 18% range.

The most common decision factors given by lender respondents when making their bids on the Paipaidai platform were:

- the borrower's credit rating (72%)
- Paipaidai's loan security guarantee (72%)
- the interest rate level of the loan (52%)
- the borrower's certification status (51%).

Most lender respondents to the survey also said they were carrying out investments on their own behalf (85%), with the remainder investing on behalf of themselves and close family or friends.

THE EVOLVING POLICY AND REGULATORY ENVIRONMENT

After allowing some years of rapid growth in peer-to-peer lending and other forms of internet finance, China's central government introduced a broad internet finance 'guidance' policy framework in July 2015. This 'guidance' policy encourages the growth and development of internet finance, including peer-to-peer lending and equity crowdfunding, while introducing relatively light regulatory measures. The key requirement for peer-to-peer lending providers is that they must now hold borrower and lender funds in custodian accounts with 'registered financial institutions'. This change raises the hurdles for providers and it is likely to lead to some consolidation, while securing the future growth of peer-to-peer lending.

REPORT METHODS

This report explores the rise of peer-to-peer lending in China to give SME communities and organisations around the world a better understanding of peer-to-peer lending and other forms of alternative finance as a viable option for their financing needs. This report takes a qualitative approach to analysis and is based on ACCA's primary research and secondary Chinese language sources.

The primary data comes from the research team interviews with industry participants in China and from the primary research survey mentioned above. Interviews were conducted with representatives from five peer-to-peer lending providers in China: Paipaidai, Jimubox, Credit Ease, Renrendai and Dianrong, and with the CEO of the China Association for Microfinance (CAM), a government-industry umbrella association covering peer-to-peer lending providers.

The online survey, carried out among borrowers and lenders who use the peer-to-peer lending provider Paipaidai, provided an understanding of their experiences, motivations and decisions. The survey methods and findings are explained in more detail in Chapter 5 of this report.

2. The growth of peer-to-peer lending in China

China's online peer-to-peer lending sector has undergone extremely rapid growth in recent years.

China's online peer-to-peer lending sector has undergone extremely rapid growth in recent years. While there is as yet no verifiable industry-wide data on the volume of peer-to-peer lending in China, secondary estimates are in the range of US$20bn–40bn for 2014 – which makes China's peer-to-peer lending sector the largest in the world.[3] The number of providers has grown considerably since 2007, when China's first unsecured peer-to-peer (P2P) lending platform, Paipaidai, started operating. By the end of 2011, 50 providers were reported to be operating and this had climbed to over 1500 providers by the end of 2014 (Figure 2.1). While the headline figures are impressive, more detailed verifiable research about the volume and composition of peer-to-peer lending is needed to get a complete picture of the sector's impact on financing dynamics in China.

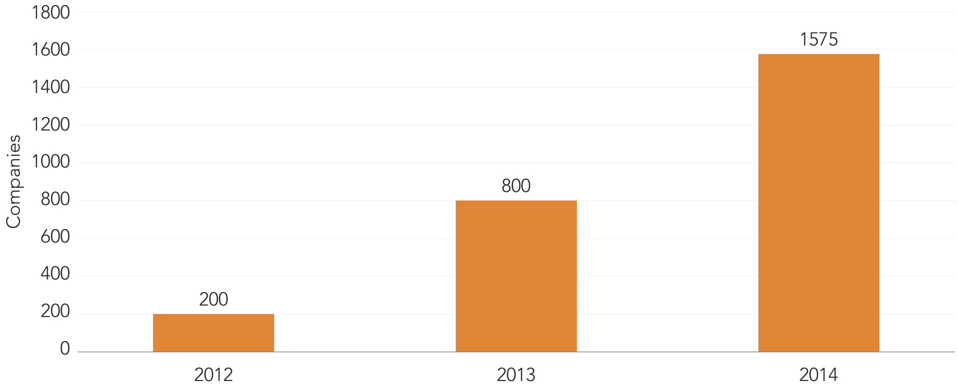
Peer-to-peer lending has the potential to transform the mass banking model in China by making it easier for the great majority of borrowers, who have low net-worth and are borrowing relatively modest amounts, to access finance. To take one example, over half the Paipaidai borrowers surveyed (Chapter 5) said they had no previous history of borrowing from traditional financial institutions such as banks, credit societies or other entities. In the year to mid-2015 Paipaidai claimed to have over 1.2m active members – of which 527,637 were individual borrowers, so potentially there could be 250,000 new borrowers on a single platform with no previous history of borrowing from traditional financial institutions or credit societies.

PEER-TO-PEER LENDING IS FILLING AN 'INSTITUTIONAL GAP' IN CHINA

A related question is the composition of peer-to-peer lending in China. Whereas peer-to-peer consumer lending has dominated developed country markets, there seems to be a much higher share of peer-to-peer business lending in China. The present research suggests that peer-to-peer business lending could be in the range of 20% to 40% of all peer-to-peer lending in China.[4] One reason for such a high share of peer-to-peer business borrowing in China is the large 'institutional' gap in the supply of finance to small, medium and micro enterprises (Shi et al. 2010: 4).

This estimate is based on the research teams' interviews with provider representatives, including PaiPaiDai, Dianrong and Jimubox. These platforms all started completely focused on lending to SMEs (including to micro enterprises) and in 2014 these platforms reported that their share of P2P business lending was in the range of 40% to over 50% of their total financing (see section 4). While this share of P2P business lending may be high compared to some other platforms in China, given the constraints on small and micro enterprising financing from traditional banks in China we expect the share of P2P business financing in China is higher than in markets with more developed SME banking systems. Further industry research on the shares of P2P consumer and P2P business lending across the sector in China is needed verify this estimate.

Figure 2.1: The number of peer-to-peer lending providers in China



Source: based on data from wangdaizhijia.com

3 Authors' estimates based on data from the online media portal wangdaizhijia.com 网贷之家.

4 The estimate that 20%-40% of peer-to-peer financing in China is peer-to-peer business financing is the authors' estimate based on the research teams' interviews with provider representatives, including PaiPaiDai, Dianrong and Jimubox. These platforms all started completely focused on lending to SMEs (including to micro enterprises) and in 2014 these platforms reported that their share of P2P business lending was in the range of 40% to over 50% of their total financing (see section 4). While this share of P2P business lending may be high compared to some other platforms in China, given the constraints on small and micro enterprising financing from traditional banks in China we expect the share of P2P business financing in China is higher than in markets with more developed SME banking systems. Further industry research on the shares of P2P consumer and P2P business lending across the sector in China is needed verify this estimate.

More detailed and verifiable research is required to get a complete picture of the changing financing composition of peer-to-peer lending in China.

Since the start of the policy era of market 'reform and opening' in the 1980s, a few massive State-Owned Commercial Banks (SOCBs) have dominated China's financial system. For most of their recent history, these large banks have predominately financed large state-owned enterprises and government-related borrowers. In contrast, the mass of the small, micro and medium-sized enterprises have relied on 'bootstrapping' from their own earnings and have tended to borrow from informal channels, especially from friends, family and business associates. Despite changes in the pattern of commercial bank financing in China over the past decade (Lardy 2014), there remains a large 'institutional gap' in the supply of finance to smaller enterprises, individuals and households (He et al. 2013).

At the same time, new financing channels have emerged out of the massive growth of e-commerce in China. For instance, by 2013 there were over 16m participating vendor businesses on the business-to-consumer online trading platform Taobao, the vast majority of which were small and micro-enterprises (Shrader 2013).[5] Among the peer-to-peer lending providers interviewed, Paipaidai, Dianrong and Jimubox also started lending solely to small, micro or medium-sized enterprise borrowers before they diversified into peer-to-peer consumer lending.[6]

In addition to small and micro enterprise financing, there is also demand from medium-sized enterprises at the larger end of the SME scale in China (these are much larger than their counterparts in more developed markets) for alternative financing arrangements.[7] Larger small and medium-sized enterprises that are seeking more flexible loan term and repayment structures than have been offered by traditional banks have generally turned to informal 'shadow bank' financing (He et.al. 2013). Yet the development of large-volume peer-to-peer business lending has the potential to meet a growing share of this demand for medium-sized enterprise financing. One example of a peer-to-peer lending provider specialising in this area, Jimubox, is discussed in Chapter 4.

Many peer-to-peer lending providers have also moved into consumer financing by offering a diversified range of lending services in areas where the traditional banks have been too slow and too cumbersome to operate – such as consumer credit, car financing, education and training, as well as mortgage financing. More detailed and verifiable research is required to get a complete picture of the changing financing composition of peer-to-peer lending in China.

5 Taobao (淘宝) is the online business-to-consumer retail platform of the e-commerce giant Alibaba.

6 For more details see the provider examples in Chapter 4.

7 Classifications for SMEs in China vary by broad industry type (e.g. primary, manufacturing, retail and wholesaling) which makes direct comparisons across sectors difficult. For example, in manufacturing a small enterprise in classified as having between 20 and 300 employees and an operating revenue of between RMB3m-RMB20m. Yet a small retail enterprise is classified as having between 10 and 49 employees and an operating revenue of between RMB1m-RMB5m. For details see Appendix 1.

3. Financial innovation and peer-to-peer lending in China

Online peer-to-peer lending is a financial innovation that has been rapidly diffused and adapted in China.

Online peer-to-peer lending is a financial innovation that has been rapidly diffused and adapted in China. This chapter looks at ACCA's framework for conceptualising the types of financial innovations involved in peer-to-peer lending and how they have been adapted in China. This framework considers financial intermediation through an understanding of how four intermediate 'financial' inputs are combined or applied to meet financial needs (ACCA 2014a).

These four 'intermediate' financial inputs are information, control, collateral and risk (Figure 3.1). Different 'financial technologies' combine or apply these four intermediate inputs in different ways. Financial innovation can therefore be understood as new – and usually more 'efficient' – ways of *producing* or *applying* these financial inputs to meet new or existing financial requirements or needs (ibid).

Below is a discussion of how peer-to-peer lending models in China produce and combine three of these intermediate financial inputs: information, collateral, and risk.

INFORMATION

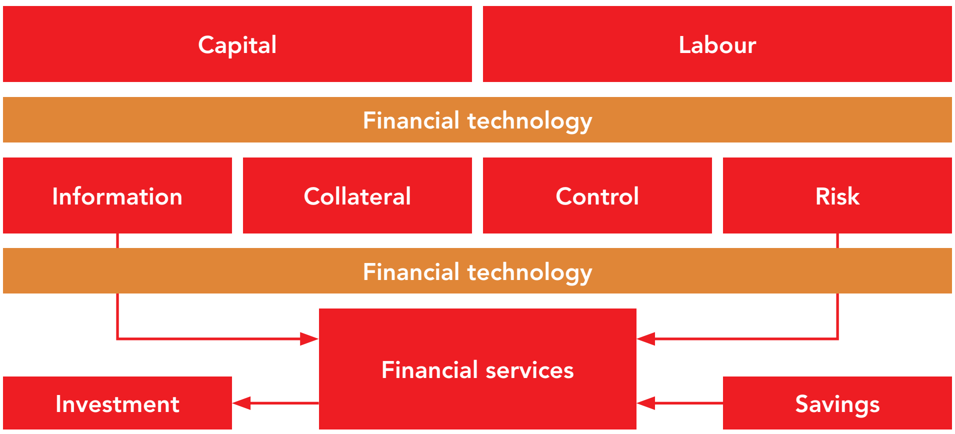
'Information includes any information that can be used to infer the risk or returns involved in a project in need of financing. This can be financial or non-financial, "hard" or "soft", highly structured or unstructured, internally generated or bought-in. It can be embedded in risk or valuation models, or sifted from rumour and word-of-mouth.' [8]

Online peer-to-peer financing entails an innovation in the way in which 'information' inputs are produced and applied. Economists have long held that banks and individual lenders face large transaction costs in lending to small borrowers because of the relatively high 'information asymmetries' arising from the lack of detailed information available to the lender about the capacity and the willingness of small and especially unsecured borrowers to repay loans. Peer-to-peer lending technology substantially reduces these 'information asymmetries' by pooling small borrowers and aggregating their loan-bid and existing credit information. In China, peer-to-peer lending providers are able to *bring in* and systematise existing credit and credit proxy information from a range of online third-party providers, including:

- records of existing personal or business credit information from traditional and non-bank financial institutions, including credit information from the central bank's national credit-registry system and 'movable assets' registry information for accounts receivables
- personal ID checks on individual borrowers or fundraisers with the local police bureau and via social media profile registrations
- data on the recent trading history of individual business borrowers, such as their e-commerce or 'Taobao' trading history.

Peer-to-peer providers also *produce* new forms of credit information by aggregating and listing current loan-bid details, previous borrowing histories, and ideally the number of current bids in a real-time online marketplace. Mobile credit assessment teams also speed up offline information collection.

Figure 3.1: ACCA's Four Inputs Framework



Source: ACCA 2014a

8 The definitions for the four intermediate inputs: information, collateral, control and risk, quoted in bold in this section are from ACCA (2014a).

Decision making (i.e. resource allocation) also involves transaction costs, especially time. In direct peer-to-peer financing, the costs of evaluating and making decisions about whether to lend or not, and on what terms, are borne by individual lenders, rather than by bank credit officers. Financial decision making in peer-to-peer lending therefore reduces the amount of time it takes to contract loans because it distributes decision making time across a large number of individual lenders rather than a few loan officials, and it expands the potential scale of lending. Online platforms can also reduce the high fixed costs of traditional bank branch-office networks.

COLLATERAL

'Collateral includes any assets that can be used in order to compensate investors for losses. This can range from personal guarantees to real estate and equipment owned by the business, and can also include intangible assets such as intellectual property (IP). Collateral and Control inputs can often overlap, insofar as pledged collateral motivates business owners or management to deliver the promised returns to investors.' [9]

Peer-to-peer providers on both the investor (lender) and borrower sides in China use collateral.

Collateral pledged by providers to compensate investors

Most peer-to-peer lending providers in China have so far offered investors outright or conditional guarantees on their investment principal and, in some cases, have even guaranteed interest rate returns to investors as well. These practices may end under the current government regulatory framework.

New forms of collateral provided by borrowers

Personal, small, and micro enterprise borrowers tend to have limited tangible assets that can provide collateral. Tangible assets enable a form of trust, which is essential for financial contracting. As with traditional forms of lending, borrowers with tangible assets can borrow greater amounts on terms that are more flexible. Peer-to-peer financing providers may seek to verify the tangible assets of potential borrowers through physical site visits. An important innovation in collateral inputs in China has come from the development of a regulatory infrastructure for 'movable assets' by the People's Central Bank of China (PBOC). The PBOC launched an online asset registry for 'accounts receivables' in 2007, which enables short-term loans to be secured against specific receivables (known as 'movable assets') (ACCA 2014b).

> Peer-to-peer lending involves an innovation in risk by transferring credit risk from financial institutions and dispersing it among individual lenders.

There has been a substantial rise in the share of lending to SMEs from both traditional and non-traditional financial institutions since the establishment of China's national 'movable assets registry' (Love et al. 2013). Yet because peer-to-peer lending providers are not 'registered financial institutions', they have not had easy access to the online credit registry information system until recently (Jiang 2015). Moreover, many potential enterprise borrowers are simply not registered.

Unsecured lending, which is offered by many peer-to-peer lending providers, also relies on trust generated through intangible collateral, mostly in the form of the reputational 'capital' of borrowers. The survey findings (Chapter 5) show that individual borrowers may seek to accumulate a favourable credit history by creating a record of loan repayment via repeated peer-to-peer borrowing.

RISK

'Risk refers to investors' willingness to take on risk, as well as their ability to manage, diversify and terminate their exposure. The simplest "Risk" input is the participation of new, more risk-loving investors in a market. More complex inputs include the services of investment managers or the presence of liquid secondary markets.' [10]

Peer-to-peer lending involves an innovation in risk by transferring credit risk from financial institutions and dispersing it among individual lenders. Indeed, peer-to-peer lending is a new low-threshold investment channel for retail investors in China. The emergence of investor-herding, as more and more investors pour into the market expecting guaranteed returns, is a risk for providers and for the sector, because most providers have a much lower capital-to-loan buffer ratio than traditional banks to cover any sharp rise in borrower default rates.

Investors are encouraged to diversify and spread their exposures by investing small amounts across a large number of individual loans. The providers interviewed have developed different mechanisms for managing high levels of investor risk by seeking to educate investors on diversification. Some providers have also developed automated investment and diversification mechanisms and some make loan guarantees conditional on investors' sufficient diversification of their lending.

The development of liquid secondary markets for trading outstanding loan contracts is another way in which providers seek to mitigate risk for investors. Liquid secondary markets mitigate the problem of liquidity mismatch (arising from the different liquidity preferences of borrower and lenders) in which borrowers tend to prefer longer loan terms than investors. Investors in liquid secondary markets can manage and terminate their exposure by selling primary loan contracts before the loan reaches maturity. More liquid secondary markets allow investors to manage their exposure more easily, encouraging more lenders, and it lowers the cost of credit, which encourages more borrowers into the market.

9 ACCA (2014a).
10 ACCA (2014a).

4. A typology of peer-to-peer lending models in China

China's peer-to-peer lending sector has a more diverse set of provider models than is the case in the US, UK or elsewhere.

China's peer-to-peer lending sector has a more diverse set of provider models than is the case in the US, UK or elsewhere. The differences in provider models arise from the diverse provider origins and from different provider responses to the challenges of limited credit information, the nature of investor risk and different borrower segments. Because of the relative lack of reliable credit information, peer-to-peer lending providers in China tend to rely much more on offline processes.

The rapid growth of peer-to-peer lending after 2012 was part of the rapid growth of the 'shadow banking' system. Some major providers are really hybrid non-traditional wealth-management companies with peer-to-peer lending businesses, while some local providers of peer-to-peer lending have emerged from small informal banks. Possibly only a minority of peer-to-peer lending providers currently operating in China were started as dedicated peer-to-peer technology-based lending companies.

A TYPOLOGY OF PEER-TO-PEER LENDING MODELS

Peer-to-peer consumer and peer-to-peer business lending are common in China. In addition to borrower type, the typology of peer-to-peer lending models in China used in this report (Figure 4.1) captures three other distinctions – whether the provider model is based on direct peer-to-peer or indirect lending, the use of new financial technology-based processes or more conventional credit-assessment processes, and the role of online or offline processes. These distinctions are explained below and illustrated through provider examples.

DIRECT PEER-TO-PEER LENDING

Direct peer-to-peer lending entails direct financial contracting between individual borrowers and individual lenders. RenRenDai, Paipaidai, Jimubox and Dianrong are examples of direct peer-to-peer lending service providers in China.

POOLING AND INDIRECT LENDING MODEL

Under indirect peer-to-peer lending, the financial contracts are not made directly between individual lenders and borrowers; instead, the providers assign credit to borrowers from pooled investor funds, which may have also undergone some form of further asset transformation. The combination of investor guarantees and the risk transformation involved in this model means that the risks entailed are less transparent than in direct lending models.

NEW FINANCIAL TECHNOLOGY-BASED PROVIDERS

Another distinction in China is whether the providers are new financial technology-based providers or whether their 'financial technology' is based on conventional credit allocation processes with an online 'shop-front'. Paipaidai, Jimubox and Dianrong are examples of new financial technology-based providers.

WEALTH MANAGEMENT COMPANIES

A number of prominent peer-to-peer lending providers in China are also primarily wealth- and asset-management companies, engaged in several lines of business. One of the largest is Lufax, which was founded in 2011 as a subsidiary of China's largest insurance provider, PingAn insurance. Alongside peer-to-peer lending, Lufax runs a major secondary trading business and raises corporate finance through securitisation. Credit Ease is another major wealth-management company with a peer-to-peer lending business. Informal small bank lenders also operate hybrid business models that offer a range of 'wealth management' services alongside 'peer-to-peer lending'.

ONLINE VERSUS OFFLINE PROCESSES

Cutting across these models is the use of online and offline processes. The ways in which peer-to-peer lenders in developed markets lend money tend to be much closer to pure online financial contracting models based on new financial technology and detailed external credit-ratings data. In contrast, peer-to-peer lending providers in China tend to rely much more on offline processes. On the borrower side, this difference is explained by the relative lack of comprehensive credit information, which means there is a greater role for providers in offline credit investigations. Providers in China also tend to use offline processes to educate and consult with individual investors.

Table 4.1: A typology of peer-to-peer lending provider models in China

	Direct lending				Indirect lending
Types	Mostly offline	Online & offline	Online & offline (technology based)	Mostly online (technology based)	Pooling & tranching
Provider examples	Credit Ease	RenRenDai	Jimubox, Dianrong	PaiPaiDai	Lufax

Source: Report authors. Note: Lufax has both direct peer-to-peer lending and large volume indirect lending businesses.

200%

growth over the past five years, and by mid-2014 Paipaidai's total transaction volume was over RMB1.4bn

PROVIDER CASE STUDY EXAMPLES

Mostly online – ppdai.com (拍拍贷)

Paipaidai began operation in 2007 as the first direct peer-to-peer technology-based lending company in China. Paipaidai is the closest to a pure online lending model and is based on lending small and micro loans to online borrowers. The total registered membership was around 1.2m people between 2014 and 2015. Over half its members are under 30 years old and over 80% are male. Paipaidai has experienced 200% growth over the past five years, and by mid-2014 its total transaction volume was over RMB1.4bn.[11]

In an interview, Paipaidai co-founders Zhang Jun and Hu Honghui described how, in Paipaidai's lending model, borrowers submit an online loan application to Paipaidai, which includes the borrower's personal information (photo ID, address, and phone number). Paipaidai then verifies borrower's information, holds an online video chat with the borrower to ask follow-up questions and then assigns a credit rating to the borrower. Where borrowers have an online trading history, their data and credit information are relatively easy to verify. The borrower's loan request is then posted as an auction-style listing on Paipaidai's website. Investors can view all borrower listings online and pick the investments that match their portfolio. Paipaidai will guarantee the investor's principal if they have fully diversified their investment portfolio.

Mostly offline – CreditEase.cn (宜信)

Some providers rely much more heavily on offline processes to source borrowers and lenders, using a network of local offices, to verify credit information and to contract lending. Credit Ease fits this model. CreditEase is a wealth-management company with a mostly offline peer-to-peer lending business. CreditEase started its lending business in 2006 by lending small loans to students in a technical and training agency. CreditEase works with offline third-party agencies to find borrowers and lenders, and has opened offline branches in most major cities.

In an interview, Chen Huan, CreditEase's chief strategy officer, explained that for CreditEase the difficulty of verifying credit information means that only a very small percentage of lenders are qualified for online borrowing. CreditEase therefore relies primarily on its offline branches to verify borrowers. The credit verification process is more like that of a traditional bank, in which offline credit officers approve lending. CreditEase offers both collateralised and non-collateralised loans. With property as collateral, lending amounts can range from RMB300,000 to RMB4m. Non-collateralised loans can range from RMB50,000 to RMB100,000.[12] The loan term is up to two years.

While all loan contracts are between individual lenders and borrowers, CreditEase acts like a broker. The company charges all borrowers a flat rate of 12% interest on the value of the loan, regardless of the risk level. In addition to the flat fee of 12%, the company also charges borrowers an additional interest rate fee depending on the type of loan product (there are six different loan products) and its assumed risk level. Borrowers pay the flat 12% interest plus the loan product fee, which brings the total interest fee to the borrower to between 12% and 24% interest on the principal. All lenders receive a list of recommended borrowers to choose from; if they do not like the borrowers on the list, they may ask for a new list.

Lenders are offered a flat 12% interest rate return on their principal regardless of the risk level of the loan. The additional interest charge to the borrower (for the loan product) is deposited by the company in a 'bad loan reserve', which is used to satisfy loan guarantees on the principle in cases where borrowers end up defaulting. The average investor amount is about RMB500,000 and the average loan size is around RMB50,000.

11 The official name of the Chinese currency is the renminbi (RMB) and its unit of account is the yuan.

12 The average CNY (RMB) to USD exchange rate was 6.2 RMB to 1 USD in the year to 18 September 2015. Author's calculation based on data from, <http://www.federalreserve.gov/releases/h10/hist/dat00_ch.htm>.

> In response to investor-risk, Dianrong has developed a group-investing product through which investors group together to pick a loan strategy in which direct contracting and diversification is fully automated through a real-time transactional system.

Online and offline

Dianrong, Jimubox and RenRenDai are examples of peer-to-peer lending providers that combine new online financial technology with offline processes.

Dianrong.com (点融网) is a technology-based peer-to-peer lending company that started operations in March 2013. Dianrong was co-founded by Soul Htite, who had also co-founded Lending Club in the US and who had been a leader in using technology to automate much of the credit-lending cycle. Dianrong started by building a technology-based direct lending platform for SMEs and then moved into personal lending. Slightly more than half of Dianrong's lending business is conducted with SMEs.

In an interview, Pan Jing, Diangrong's chief media officer, explained that although the initial idea was for Dianrong to replicate the technical and operational model of Lending Club, the founders realised this approach was not viable because of large differences in the availability of credit information and very different investor characteristics in China from those in the US. In response to investor-risk, Dianrong has developed a group-investing product through which investors group together to pick a loan strategy in which direct contracting and diversification is fully automated through a real-time transactional system. As new investors join and new loans become available, the group-investing product automatically divests among more borrowers.

This group-investing product differs from the practice of pooling funds and investing through trusts or index funds, which can be less transparent. In Dianrong's group-investing system, the contracting remains direct contracting and all details are available to investors through a real-time transactional system. Dianrong offers a guarantee to investors on their principal, but this is conditional on their investing through a heavily diversified group investment system.

Dianrong emphasises the need for offline processes because of the relative lack of reliable credit information on borrowers in China. Dianrong seeks to establish a direct offline relationship with borrowers. The company has 11 offices spread across China and many of its borrowers come from referrals from its own offline offices and teams. Dianrong uses site visits to verify borrowers' information. Personal loans made via Dianrong average from RMB50,000 to RMB150,000. SME loans are RMB1m–2m in average size. The interest rates vary from 8% at the lowest to 20% at the highest. The loan terms are from 1 month to three years. Dianrong is also involved in establishing a number of partnerships with local banks, such as Suzhou Bank, to start peer-to-peer lending platforms. Under these partnerships Dianrong provides the technology services and the platform is operated by the bank.

Jimubox.com (积木盒子) is a direct peer-to-peer lending platform with its headquarters in Beijing. In an interview, Jimubox co-founder, Barry Freeman explained how it had started lending in August 2013 and by the end of November 2014, it had about half a million users, over RMB3bn in total lending and about RMB 540m in current lending. In July 2015, Jimubox's primary trading volume had climbed to RMB900m, with another RMB200m in secondary trading of primary loans. Because Jimubox was later to start online peer-to-peer lending in China, the founders sought to establish the company with a business model aligned with the expected incoming sector regulations. Jimubox does not use credit pooling (rather, all lending is direct one-to-one lending) or any form of loan guarantees for investors (on either principle or interest), which means that the business is in line with recent and expected regulatory changes.

Small and medium enterprise (SME) lending is the largest Jimubox loan category. Jimubox's SME loans are mostly for larger enterprises, with loan sizes ranging in value from RMB1m up to RMB15m. For a loan bid to be registered on Jimubox, SME borrowers must have an approved third-party credit-guarantee company backing their bid. Loans must have some form of 'credit enhancement' and 'security'. While loans are always made to individual SMEs, the bid registration process may come from the SMEs themselves or from third-party credit-guarantee companies ('channel partners') seeking to raise funds for individual SMEs via Jimubox.

Many of Jimubox's loan bids are contracted online by investors via bids made on their smart-phones through a Jimubox app.

Jimubox started with a 100% SME loans business but that mix is now changing dynamically towards other categories: consumer lending, luxury car lending, and mortgage-based lending (bridging finance). Consumer loans tend to be from RMB50,000 to RMB100,000, while bridging finance loans for property sales range from RMB500,000 to as high as RMB6m.

Jimubox also relies on offline operations, such as monthly investor meetings and site visits by local credit-risk-assessment field teams. To register a bid for a loan, all borrowers must undergo Jimubox's due diligence based on primary verification data. Many of Jimubox's loan bids are contracted online by investors via bids made on their smart-phones through a Jimubox app.

Local credit-risk-assessment field teams also use a mobile application which allows them to upload details from site visits (photos, financial data, records, etc.) for central processing by the credit-risk team in Beijing. Detailed loan data for all historical loans and for all current bids are also available online, and are processed via the internal credit-risk system. Jimubox sees this high level of information transparency as a differentiator. Jimubox also has one of the most developed secondary liquidity markets for its loans. Liquidity risk (arising from liquidity mismatch) is a problem for direct lending – investors often want to make short-term loans of a few months, whereas borrowers often want longer terms of up to a year. To get around this mismatching, there is an active secondary market for Jimubox loans. Each month, investors trade as much as 25%–27% of its loans by value in a secondary market.

Renrendai.com (人人贷) is a direct lending company with an online direct lending business, but which mostly operates offline peer-to-peer lending. In an interview, Tang Nan, RenRenDai's government affairs director, explained that the loan amounts range from RMB3000 to RMB200,000 and loan terms are from 3 to 36 months. RenRenDai had 1m total users and an active membership of about 250,000 members at the end of 2014. Although RenRenDai has a mostly offline lending model, it also has an online lending business with lower loan sizes.

For a borrower who is registered online without a third-party referral from a loan company, the minimum loan amount is RMB3000 and the maximum is around RMB8,000–10,000. Borrowers are asked for their basic information, which is cross-verified and checked against RenRenDai's credit-rating model. RenRenDai also relies on offline referrals from loan guarantee companies. The main offline lending business funds borrowers who are registered via an offline referral from third-party lending companies. The minimum borrowing amount for registered offline borrowers is about RMB50,000. RenRenDai has a bad-loan reserve fund that is managed by a third-party bank and is used for covering losses on investor principles.

5. Survey findings from Paipaidai borrowers and lenders

For this report, borrowers and lenders using the peer-to-peer lending platform Paipaidai were surveyed in early 2015 with the aim of gaining a more detailed understanding of their financing needs, motivations and choices.

For this report, borrowers and lenders using the peer-to-peer lending platform Paipaidai were surveyed in early 2015 with the aim of gaining a more detailed understanding of their financing needs, motivations and choices. There were 935 valid responses from Paipaidai members, out of a potential pool of 180,000 members who had open contracts at the time of the survey.

SURVEY METHODS

The research team designed a detailed qualitative survey questionnaire, which was hosted on a secure online server and was live for six weeks from 25 January to 15 March 2015. An online survey link from Paipaidai's social media messaging system was sent to all Paipaidai members with current open contracts on the platform. Respondents self-selected to participate in the survey. Respondents had to enter a valid Paipaidai membership name and number. All respondents were given the first part of the survey that asked basic demographic questions. Respondents were also asked to self-select for part two of the survey, which was about their main use of the platform, i.e. whether they were individual borrowers, lenders, business borrowers or dual borrowers and lenders on the platform. The survey data were then anonymised before being analysed by the research team.

SURVEY RESPONSES

Out of 935 valid online survey responses from Paipaidai members, 342 respondents identified as individual borrowers and 515 as individual lenders. A further 35 respondents identified as business borrowers and another 43 respondents said they were both borrowers and lenders. Selection bias is inherent in self-selection based surveys and some types of respondents may be overrepresented while others may be underrepresented compared with the general population. In this case, the individual borrowers responded at a much higher rate than business borrowers.

According to Paipaidai, about 40% of the company's borrowers are small and micro businesses yet most borrower respondents to the survey said that they were individual borrowers rather than business borrowers. This is discussed in the individual and business borrower sections below. Nevertheless, the socio-demographic characteristics of the survey respondents are almost identical to data on the general population of Paipaidai platform members, which was provided to the research team by Paipaidai. The survey responses are below.

INDIVIDUAL BORROWER RESPONSES (n = 342)

Male, young and tertiary educated

The demographic profile of individual borrower respondents on the Paipaidai platform was overwhelming male (88%) and young, with 64% of individual borrower respondents reporting that they were 31 years of age or less. Most individual borrower respondents were tertiary educated (56%) comprising 33% with college qualifications and 23% with university qualifications.

Low and 'mass middle class' income ranges

The majority of individual borrowers (52%) reported a *low-income range* of RMB2000 to RMB5000 a month. This monthly income range is less than a taxi driver earns in a tier-one city such as Beijing or Shanghai, and reflects the young age of individual borrowers and possibly some under-reporting of income. The next largest share of individual borrowers (36%) reported a monthly income of between RMB5000 to RMB10,000 a month – a monthly income range which a McKinsey report gives as a 'mass middle-class' income range for China (Barton et al. 2013). A minority of individual borrowers (10%) reported an 'upper middle' income range of between RMB10,000 and RMB20,000 a month.

The residential housing situation of respondents also provides a view of their relatively young age, low income and limited wealth: 30% of individual borrowers were living with their parents, 27% were in rental accommodation, 28% were in owner-occupied housing with a mortgage, and 9% owned their own home outright.

The majority of individual borrower respondents (63%) worked in private businesses. The survey data does not reveal how many of these respondents were employees or business owners, but it is clear from the reported use of funds (below) that some individual borrowers were borrowing for their own business purposes. A further 14% of individual borrowers worked in state-owned enterprises and 12% worked in public institutions or government agencies.

51%

The main loan use reported by 51% of individual borrowers was 'to accumulate credit worthiness'.

Borrowing 'to accumulate credit worthiness'

The most surprising response to the survey from individual borrowers concerned the main 'loan use' they identified for borrowing funds online. The main loan use reported by 51% of individual borrowers was 'to accumulate credit worthiness' (Figure 5.1). These borrowers were taking on interest repayments in the range of 8% to 18% interest to secure a positive online credit rating. The share of respondents borrowing 'to accumulate credit worthiness' was high across all individual borrower respondents' income and loan interest ranges, regardless of whether they had previously borrowed from other financial institutions. This suggests that, in the absence of widely accessible formal credit sources in China, individual borrowers are prepared to pay very high transaction costs to secure better financing terms in the future.

Over half (56%) of individual borrower respondents also reported that they had no previous borrowing history from other financial institutions such as traditional banks, credit societies or other entities (Figure 5.2). The next most common loan uses were 'to meet basic needs' (20%), and 'to fund major purchases' of consumer durables (9%), which are typical consumer-financing reasons. A further 7% of individual borrowers reported that they were borrowing funds to finance their own businesses, for use as working capital or to meet start-up costs.

Borrowing at between 8% and 18% interest

The interest rate borrowing range for most individual borrowers (73%) was between 8% to 18% a year (Figure 5.3). The largest proportion of individual borrowers (38%) reported borrowing at between 8% and 12% while the next largest group (35%) reported borrowing at interest rates between 12% and 18%. Most individual borrowers reported that their borrowing amounts were low. The largest proportion of individual borrowers (49%) reported borrowing between RMB3000 and RMB5000 (Figure 5.4): about a month's income at the low-income range. The next largest share of individual borrowers (20%) reported that they generally borrowed amounts of between RMB5000 and RMB10,000.

Most individual borrowers (91%) reported that they borrowed on short terms of one year or less, while the largest group of individual borrowers (40%) said they borrowed for between three to six months. The low borrowing threshold and easy-application auditing were cited by 72% of individual borrowers as their main reason for choosing internet finance loans on a platform such as Paipaidai.

Figure 5.1: Main loan use (n=341)

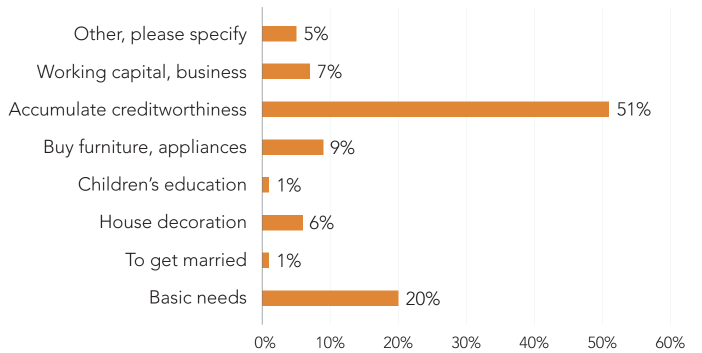


Figure 5.2: Borrowed from banking, insurance, credit or other financial institutions or entities (n=339)

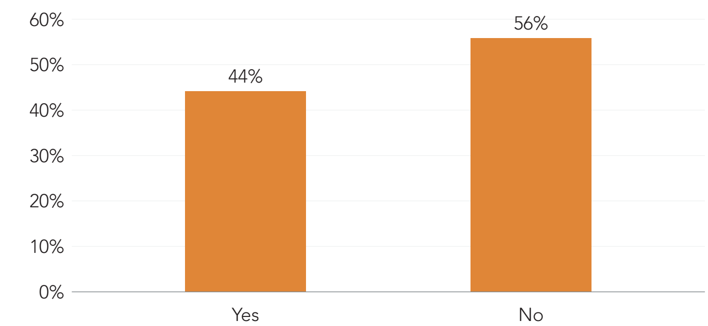


Figure 5.3: Interest rate borrowing range (n=342)

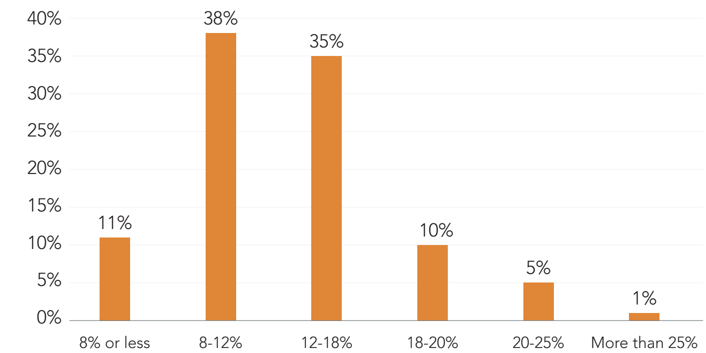
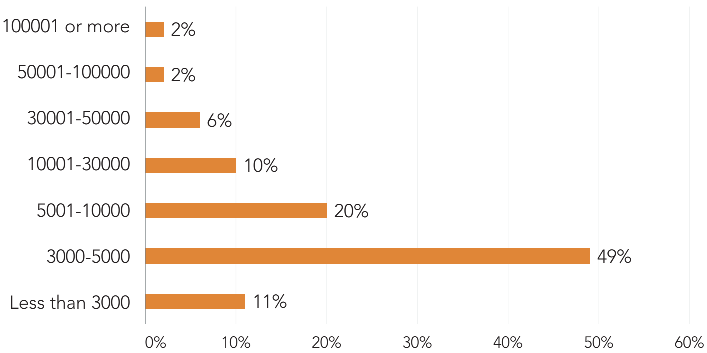


Figure 5.4: Loan value range, RMB (n=342)



INDIVIDUAL LENDER RESPONSES (n=510)

Individual lender respondents (a total of 510 of the respondents) tended to be slightly older and more highly educated than the borrowers; 80% of them said they were male, and 20% female, so women are a higher proportion of lenders than of borrowers. Lenders also tended to be young, with 73% between the ages of 20 and 38 years, but there were also more lenders (27%) who were 39 years or older. Lenders tended to be more highly educated than borrowers were: 86% of lenders had tertiary qualifications, 56% having completed university-level degrees. Of these 46% had bachelor's degrees and 12% had master's degrees.

Lenders reported higher earnings than borrowers did

While the largest proportion of lenders (46%) reported monthly incomes at the low RMB3,000 to RMB5,000 range, 39% reported incomes of between RMB5,000 and RMB10,000 a month while 14% reported high incomes of between RMB10,000 and RMB20,000 a month. The largest group of lenders worked in private business (45%). A higher proportion of lenders than borrowers worked in public institutions and government agencies (25%). The largest proportion of lenders (41%) lived in their own home without a mortgage, while another 24% lived in owner-occupied housing with a mortgage.

Lender views and motivations

Lenders were asked their main reasons (multiple responses allowed) for choosing an investment channel such as Paipaidai loans (Figure 5.5). The most common responses were to increase the number of available investment channels (76%), to realise capital gains (73%), and to get higher returns than the bank interest rate (73%). For 11% of lenders, supporting wider social development and SME financing was a reason for investing through a peer-to-peer lending channel such as Paipaidai. When asked what they thought was the largest constraint on the development of internet finance, most lenders (59%) chose 'the credit environment', followed by the level of economic development (37%). Most borrowers, in contrast, selected these constraints equally (46%), which suggests that lenders tended to be more conscious of credit risk than borrowers were!

Lender bid preferences

Most lenders (57%) said they usually bid for loans with interest rates in the 12% to 18% range (Figure 5.6), that is, at an interest rate range that was three to five times higher than the bank deposit rate at the time of the survey. The largest share of lender respondents (49%) said they generally bid for loans in a three-to-six-month term range (Figure 5.7). The most common amount that lenders bid for (47%) was in the low RMB3000 to RMB5000 range, with 20% of lenders choosing to bid for loans of less than RMB3000. Lenders were also asked to choose from a list of the main factors that they considered in making their bids on the Paipaidai platform (multiple responses were allowed, see Figure 5.8). The most common responses were the borrower's credit rating (72%), Paipaidai's loan security guarantee (72%), the interest-rate level of the loan (52%), and the borrower's certification status (51%).

Individual rather than institutional investors

Most investor respondents said that they were carrying out investments on their own behalf (85%). A further 3% said they were also investing for family and friends, while only 1% of lenders said they were investing for others on an institutional basis. In addition, 10% of individual lender respondents identified themselves as observers rather than active investors on the Paipaidai platform.

Figure 5.5: Main reasons for selecting an investment channel like PaiPaiDai to bid for lending (n=507) multiple response

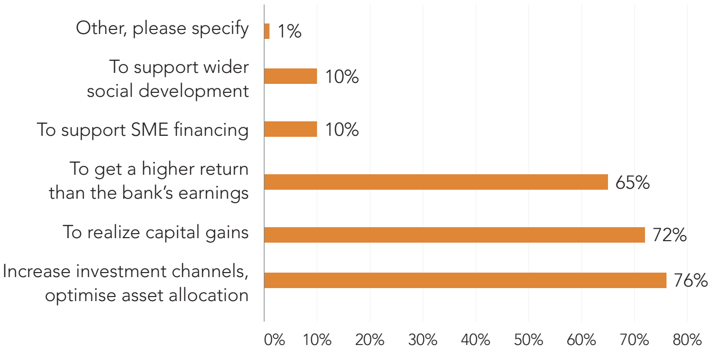


Figure 5.6: Preferred interest rate lending bid range (n=509)

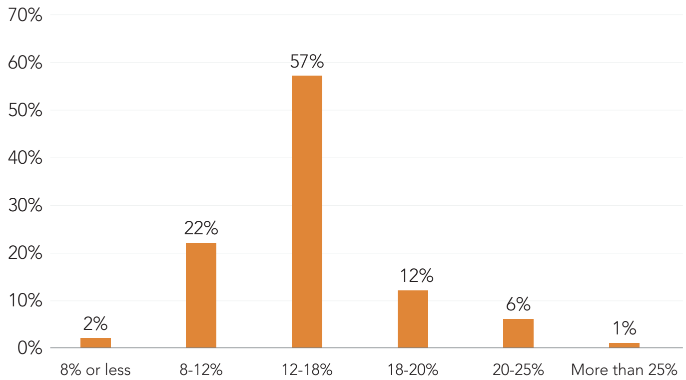


Figure 5.7: What loan term do you generally bid for on PaiPaiDai? (n=510)

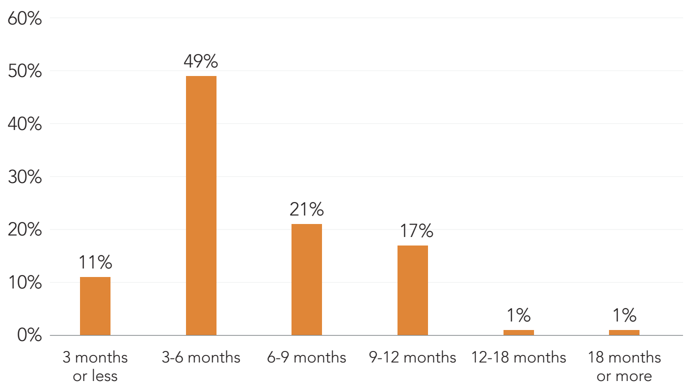
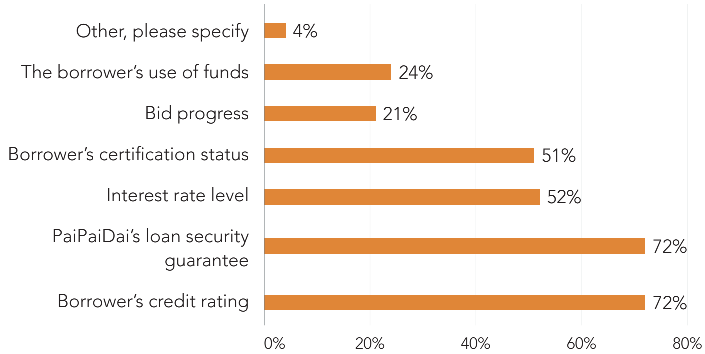


Figure 5.8: What factors do you most value in making your bids? (n=515) (multiple answers)



BUSINESS BORROWER RESPONSES (n=24)

Only 24 of the respondents completed the business borrower section of the survey. Across all borrower respondent categories, 90 out of a total of 935 survey respondents said that they were borrowing to finance their businesses, ie fewer than 10% of respondents.[13] Nevertheless, this gives some data on self-identified business borrowers. These business borrowers tended to be older than the individual borrowers. Business borrower respondents were also overwhelming male (91%) and tertiary educated (74%). Of these, 52% had completed college and 22% had university-level qualifications. Business borrower respondents reported higher monthly incomes than the individual borrowers: 43% of business borrowers reported a monthly income of RMB5000 to RMB10,000 and 35% reported a monthly income of RMB10,000 to RMB20,000, which was the highest response at this income range.

Small and micro business borrowers

The registered or operating capital of business borrowers' enterprises was very modest: the largest proportion (39%) reported between RMB100,000 to RMB500,000, and the next largest proportion (22%) reported between RMB1m and RMB5m. Most business borrowers reported very low business revenues for their most recent complete financial year. The largest proportion (45%) of business respondents reported very low business earnings of RMB20,000 or less a year. This suggests that such businesses are side-businesses and that the owners have other sources of income, or that their business is doing very poorly, or that they are misreporting. The next largest group of business borrowers (23%) reported business revenue of RMB20,000 to RMB50,000. A further 18% reported business earnings of RMB 50,000 to RMB 100,000, and 14% reported earnings in the range of RMB 100,000 to RMB 500,000. The majority (52%) reported they had 6– 20 employees, 22% had 21–50 employees, and another 22% had five employees or fewer.

Financing short-term cash flow

The most common reason chosen by business borrowers for taking out peer-to-peer loans (65%) was to meet daily short-term cash flow needs (Figure 5.9). Most had short-term loan needs of less than 12 months (87%) with the largest share (39%) seeking loans for three to six months. The most common interest rate range was between 8% and 12%. While the largest group of business borrowers (36%) were borrowing at the RMB3000 to RMB 5000 range, the loan value range was also evenly spread and included loans at higher values.

Low borrowing threshold

The most common reason chosen by business borrowers for choosing internet finance loans was the low threshold and easy borrower audit process (87%). Business borrowers were also asked what factors they thought could lower their Paipaidai loan interest rate. Their most common multiple response choices (Figure 5.10) were good loan payment transactions on the Paipaidai platform (87%), more detailed business operating information, such as their Taobao transaction history (70%), and detailed personal or business credit reports from the People's Bank of China Reports (57%).[14]

Most business borrowers were new borrowers

Most business borrowers (73%) said they had no previous experience of borrowing from other financial institutions (Figure 5.11), but most had some form of trade credit line (Figure 5.12). Trade credit lines with trading partners were the most common form of credit line (48%), followed by non-bank credit lines (39%) such as with AliFinance, the micro-credit arm of Alibaba, and bank credit lines (22%). Most business borrowers had a formal written business plan (70%), most had financially trained or qualified person in charge of business finances (61%), and reported that the produced regular management accounts (57%).

Figure 5.9: Main loan purpose (n=23)

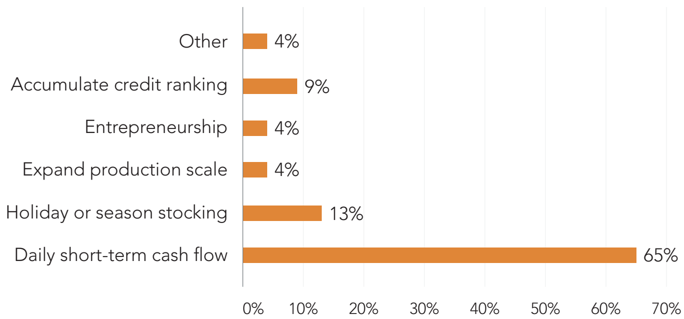


Figure 5.10: What factors do you think can lower your PaiPaiDai loan interest rate? (n=23) multiple response

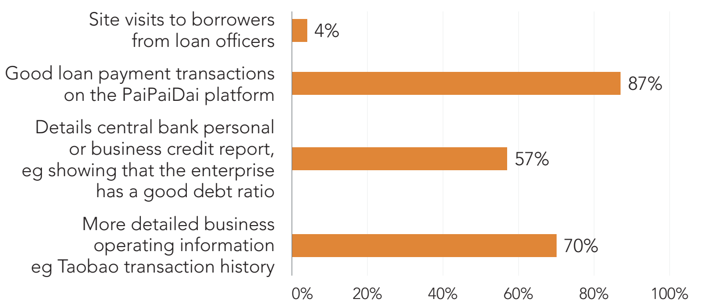


Figure 5.11: Have you borrowed from other financial institutions or entities? (n=23)

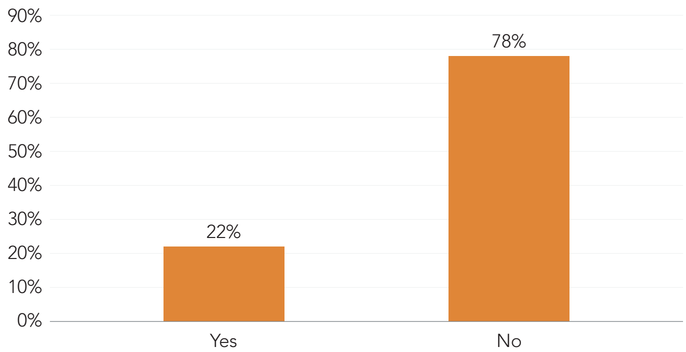
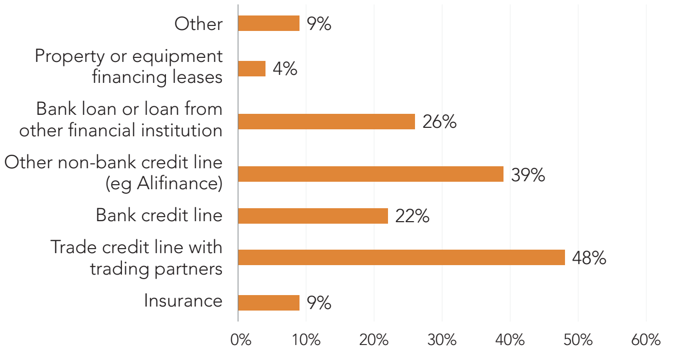


Figure 5.12: What other type of finance does your firm use (n=23) multiple response



13 In addition to the 24 self-identified business borrowers, there were 24 individual borrower respondents who were borrowing to finance business needs, including working capital or daily cash flow needs, and to start their own business ventures. A further 43 respondents who selected themselves as dual borrowers and lenders were also business owners.

14 The People's Bank of China (POBC) is China's central bank, and also maintains China's national credit-registry data centre.

DUAL BORROWER AND LENDER RESPONSES (n=43)

The survey had 43 respondents who said they were both borrowers and lenders on the Paipaidai platform. The socio-demographic profile of dual borrowers and lenders was similar to other Paipaidai members: 78% were male, 69% were between 26 and 38 years old and 69% were tertiary educated, of which 36% were university graduates and the remaining 33% were college graduates. Dual borrowers' and lenders' income and residential housing asset profiles were closer to the profiles of those who were simply lenders than the profiles of those who were simply borrowers. More than half the dual borrowers and lenders (55%) reported a monthly income of between RMB5000 and RMB10,000, while 21% reported a monthly income of between RMB10,000 and RMB20,000.

The proportion of dual borrower and lender respondents who said they worked in private businesses was 77%, compared with 63% for individual borrower respondents, while 14% said they worked in a public institution or in a government agency. The majority were property owners: 39% lived in their own home without a mortgage, while another 27% lived in their own home with a mortgage. Nearly half (49%) also said the most common way that they travelled was by car, which is higher than for the general population.

Dual borrower and lenders tended to be business owners

Most dual borrowers and lenders had their own business enterprises: 27% reported that their business had been operating for between 5 and 10 years. Most reported a very low business sales revenue, with the largest share of respondents (44%) reporting business revenue of RMB20,000 or less. Their registered capital or online shop operating capital tended to be higher than that of individual business borrowers. The largest proportion (30%) reported registered or operating capital of between RMB100,000 and RMB500,000. Most were employers: 36% had between five and nine workers, while 33% had four or fewer. There were also some larger medium-sized enterprises: 11% (four respondents) said they had between 300 and 999 workers.

Borrowing 'to accumulate credit worthiness' and for cash flow

The most common reasons selected (multiple responses, see Figure 5.13) for borrowing by dual borrowers and lenders was to accumulate credit worthiness (77%), followed by meeting daily short-term cash flows needs (67%). The largest proportion (40%) of dual borrower and lender respondents borrowed at interest rates of between 8% and 12%, with the next largest group (35%) borrowing at the 12% to 18% range. The borrowing amounts or loan values were mostly low, with the largest proportion borrowing in the RMB3000 to RMB5000 range, and the next largest group (23%) borrowing in the RMB5000 to RMB10,000 range. Their loan-term needs were short, with the largest proportion (47%) borrowing at three-to-six-month terms (Figure 5.14).

Low loan threshold given as main reason for borrowing online

The main reasons selected by dual borrowers and lenders for choosing internet finance loans were the low loan threshold and easy borrower auditing (73%) followed by the choice of interest rates (63%). Most (60%) thought that the main way they could lower their interest rate for borrowing was by accumulating a record of good loan transactions. The most common reasons chosen for being unable to obtain timely access to bank loans (multiple responses allowed) included strict loan qualifications (55%) and a shallow relationship with the banks (40%) (Figure 5.15).

Most respondents (56%) said that they had not borrowed from other financial institutions before, although as with other business borrowers most also had some form of trade credit line (Figure 5.16) either with trading partners (42%), with banks (34%) or with other non-banks such as AliFinance (32%). Most dual borrower and lender respondents (76%) reported having a formal written business plan for their business, while 45% said their business produced regular written management accounts and had a financially trained or qualified person in charge of business finances. Three respondents (8%) said they had a formal finance team.

Figure 5.13: Main loan purpose (n = 39) multiple response

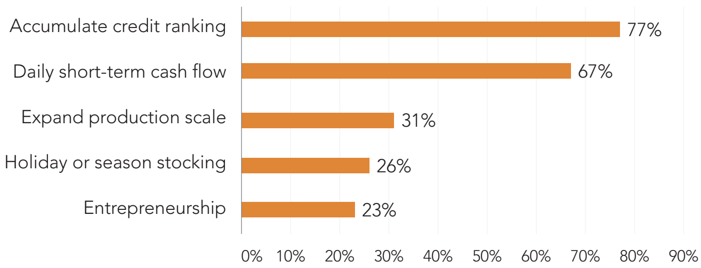


Figure 5.14: Loan term needs (n = 42)

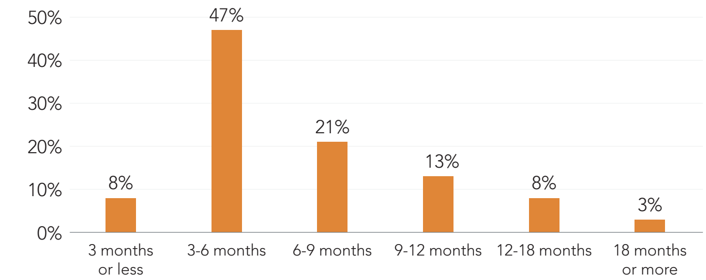


Figure 5.15: Reasons for being unable to obtain timely access to bank loans (n = 40) multiple response

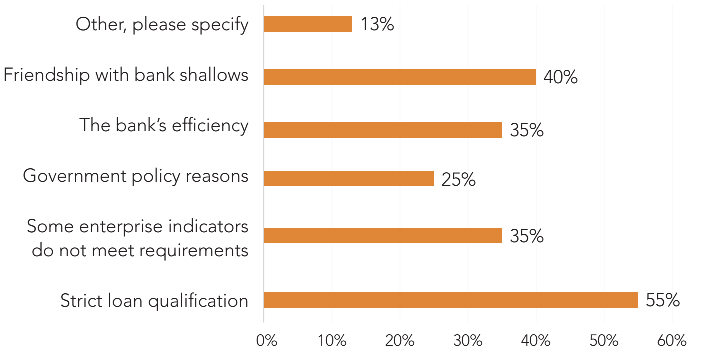
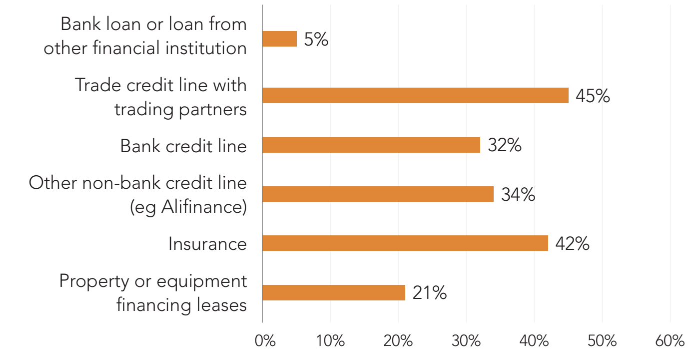


Figure 5.16: Types of finance used by respondents business (n = 38) multiple response



6. China's peer-to-peer lending regulatory framework

After allowing the rapid growth of internet finance and peer-to-peer lending for some years, China's government brought in its first major internet finance 'guidance' policy in July 2015 (PBOC 2015a).

After allowing the rapid growth of internet finance and peer-to-peer lending for some years, China's government brought in its first major internet finance 'guidance' policy in July 2015 (PBOC 2015a). The 'guidance' policy is a broad framework that 'actively encourages the development of internet finance platforms' and is intended to 'encourage innovation and support the steady development of internet finance' with 'moderately loose regulatory policies'.

The key regulatory policy change for peer-to-peer lending providers is the requirement that they establish a third-party depository system for customer funds with a 'qualified banking institution'. This means customer funds for both borrowers and lenders must be kept with a commercial bank, rather than by the peer-to-peer provider itself or with some other non-bank payment institution. The custodian account acts as the fund transfer mechanism between lenders and borrowers, and escrow, for all transactions between both sides. Custodian accounts offer a greater degree of protection for lenders and borrowers, and this new requirement for peer-to-peer platforms will consolidate the sector among those providers who can secure custodian accounts with the banks. In line with the regulation on custodian accounts, the 'guidance' policy also appointed the China Banking Regulatory Commission (CBRC) as the peer-to-peer lending supervisory agency.

Following the publication of the 'guidance' policy in July 2015, the government also introduced new non-bank payments regulations, which place tight limits on non-bank third-party transaction sizes for individual accounts that are not linked to real-name individual primary bank accounts with qualified banking institutions (PBOC 2015b). One of the aims of this policy is to make it more difficult to conduct 'illegal' financing activities through non-bank payments and financing channels, including peer-to-peer lending.

The 'guidance' policy also brings peer-to-peer lending providers and their data into the central bank's national Credit Registry Centre (CRC). Although the CRC was started in 2006, the system has major gaps in coverage. The rise of online payments systems and internet finance has brought an abundance of new credit information. Yet non-qualified financial institutions, such as peer-to-peer lending companies, had not had formal access the national CRC or been required to provide their credit data. The 'guidance' policy changes this rule and seeks to integrate peer-to-peer lending providers and their data into the national credit registry system, following steps in this direction in recent years (eg Jiang 2015).

While the new regulatory requirements for peer-to-peer lending providers are relatively light so far, CBRC officials have foreshadowed a number of policy 'red lines' for the sector (Hexun 2014, Xicai 2014). These 'red lines' include that:

- minimum registered capital requirements will be imposed for internet finance companies
- capital pooling will not be allowed (only direct one-to-one lending allowed, no fund pools)
- loan guarantees will not be allowed (on principle or investment)
- providers must have experienced management and credit-risk management teams.

These policies on ending provider loan guarantees on investor principals and minimum capital requirements for providers have not been implemented, as of September 2015. The 'capital pooling' red line seeks to maintain a clear line between direct peer-to-peer financing and traditional banking. According to the 'guidance' policy, providers should not act as 'credit intermediaries' engaging in 'enhanced' financial services, through the pooling and transformation of financial assets (PBOC 2015a). Rather, providers should restrict their activities to 'information intermediary' services and to enabling direct one-to-one lending. Although the 'red line' against 'capital pooling' models appears in the guidance policy, whether and to what extent this principal will be enforced by the CBRC is yet to be seen. Overall, the 'guidance' policy formalises peer-to-peer lending in China and imposes some basic requirements on providers, which will consolidate the sector while encouraging its further growth.

7. Conclusion

Understanding the development of peer-to-peer lending in China can help SME communities and organisations understand and explore peer-to-peer lending and other forms of alternative finance as viable options for their financing needs.

Understanding the development of peer-to-peer lending in China can help SME communities and organisations understand and explore peer-to-peer lending and other forms of alternative finance as viable options for their financing needs. Peer-to-peer lending is an innovative and rapidly growing alternative financing channel in China; it entails innovations in the production and application of the intermediate financial inputs of information and risk.

Peer-to-peer lending reduces the costs of obtaining and evaluating borrower credit information and decentralises financial decision making, handing that power to individuals. The potential effect of these innovations is to lower the traditionally held barriers to financial access for the mass of personal and business borrowers in China, as it does in many developing countries across the world (World Bank 2013).

Peer-to-peer lending in China has already potentially lowered the credit access threshold for millions of consumers and small and micro enterprise borrowers. Over half the borrowers who responded to the survey said they had no prior borrowing history from either traditional financial or other credit institutions. While many peer-to-peer borrowers are personal borrowers, this research suggests that business borrowers – mostly owners of small and micro businesses – could account for 20% to 40% of peer-to-peer borrowers in China.

At the same time, China's unique credit environment has led to a distinctive set of peer-to-peer lending provider models in China. Because of the limits of reliable credit information, peer-to-peer lending providers in China also tend to rely much more on offline processes than their counterparts in more developed countries.

Much of the discussion of peer-to-peer lending in China has centred on the potential risks posed by the sector. In the absence of accessible institutional channels for gaining access to credit, the ACCA's survey findings show that unsecured borrowers' may seek to 'accumulate creditworthiness' through borrowing and meeting loan repayments. This suggests that online platforms create transparency, which is a mitigating factor against the risk of fraud and credit default. The development of a regulatory infrastructure, which can verify or provide proxies for credit information, is also crucial to extending access to finance (ACCA 2014b: 4).

After some years of allowing the rapid growth of internet finance, China's government introduced its first detailed 'guidance' regulations on internet finance, including peer-to-peer lending, in July 2015. The most significant regulatory change is the requirement that peer-to-peer lending providers hold all borrower funds in custodian accounts with 'registered financial institutions'. This raises the regulatory hurdles for peer-to-peer lending providers and it will lead to some further consolidation of the sector. It will also place peer-to-peer lending providers that meet the new regulatory standards on a much firmer footing in future.

As China's peer-to-peer lending sector and other new forms of alternative finance, such as equity-based crowdfunding, develop, more detailed efforts by policymakers, regulators and interested parties, including ACCA, will be needed to ensure that there is detailed reliable data on the development and outcomes of alternative financing for SME communities. To this end, international effort to conduct detailed primary research on the scale, composition and the financial outcomes of peer-to-peer lending and other alternative financing activities would also help identify and promote examples of legal and regulatory 'best practice' in regulating new alternative financial services for individuals and SME communities in different jurisdictions.

Appendix 1: SME classifications in China

Table A1.1: SME classification standards in China (2011)

		No. of employees	Operating revenue (in million RMB)
Farming, Forestry, Animal Husbandry & Fishery	Medium		5-20
	Small		0.5-5
	Micro		<0.5
Manufacturing	Medium	300-1,000	20-40
	Small	20-299	3-20
	Micro	**<20**	**<3**
Retail Trade	Medium	50-300	5-200
	Small	10-49	1-5
	Micro	<10	<1
Wholesaling	Medium	20-200	50-400
	Small	5-19	10-49
	Micro	<5	<10

Source: P.R.C. Ministry of Industry and Information Technology, National Bureau of Statistics, National Development and Reform Commission, Ministry of Finance, *On the issuance of standards for SMEs plan type*, [2011] No. 300, June 18, 2011.

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