P2P Lending Market in China

Commissioned by

Boao Review
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Table of Contents

Section 1. An overview of the P2P Lending Market in China ......................... 3
Section 2. Marketing Management Analysis ................................................. 16
Section 3. Credit Management Analysis ....................................................... 20
Section 4. Risk Management Analysis .......................................................... 25
Section 1. An overview of the P2P Lending Market in China

1. Overview

P2P lending originated in the UK and was developed in the US, before reaching a peak in China. In March 2005, British entrepreneurs Richard Dewar, Sarah Mathews, James Alexander and David Nickerson co-founded Zopa, the world’s first online lending website serving as an information exchange platform for small businesses and individuals seeking funding sources. P2P lending debuted as a new business model. Later on, two similar sites, Proper Market Place and Lending Club, emerged in the US in 2006 and 2007, respectively. They claimed the lion’s share of the American P2P market. A timeline of P2P’s origin and development overseas can be found below.

Inspired by P2P platforms in the US, Ppdai went live online in June 2007 as the first P2P lending website in China. It was followed by the emergence of a number of major online lending platforms of a similar type, including Hongling Capital, Renrendai and Lufax. The industry as a whole entered the “fast lane” and developed rapidly. From 2012 onward, the Chinese P2P industry has enjoyed exponential growth with multifold increases across all main indicators such as the number of investors, borrowers, platforms and business turnover.

In terms of income structure, P2P platforms generate most revenues through loan management, interest management and other value-added services. Of them, loan management charges account for the largest proportion (over 70%) of total platform revenues. Detailed industry regulatory policies are still unavailable as yet. However, P2P platforms have clearly positioned themselves as information providers and deal-making platforms, with a strict ban on capital pool building using deposits from the public. In practice, however, most platforms have not disclosed their revenues, expenses or funds allocation, and rely on (secretly earned) interest spreads as a profit source. Not factoring in expenses they incurred in compensating bad debts, gross margin in the P2P lending business is pretty high and may even exceed 20% in some cases.

This is why the P2P industry has attracted investment from various capital operators including micro-finance, guarantee, venture capital and publicly listed companies, banks and even local governments, and why the number of P2P platforms in China has gone through explosive increases in recent years.

Despite the fact that the majority of platforms operate “quasi-banking” businesses, their risk control operations are of lower quality relative to traditional banks. Moreover, potential risks are mounting in the P2P industry due to deficient internal management and loopholes in existing laws and regulations. According to statistics released by 01caijing.com, as of the end of 2014, 344 Chinese P2P platforms had “fled”, accounting for 20.3% of the total number of platforms in the country. To a certain extent, this dampened investors’ enthusiasm and had an adverse effect on the industry, as well as posing a grave threat to the growth of the P2P market as a whole.

Admittedly, the domestic P2P lending industry is flawed by substantial risks, but as a positive endeavor to address financing difficulties of small businesses, it has played an important role in breaking the bottlenecks in business financing, facilitating financial innovation and building an inclusive financial system. Therefore, the government and relevant industry associations should provide guidance to ensure the healthy development and standardized operations of the P2P market. It is reported that initial “top level” design has been completed for domestic P2P regulation, and detailed industry regulation rules will also be introduced in the near future.
2. **Borrower profile**

As the users and one of the main players in P2P loans, P2P borrowers are a decisive factor in shaping the risk profile of P2P investment activities. A clear understanding of the borrowers’ overall status is of crucial significance for practical credit risk control on P2P lending platforms.

Specifically, five indicators are employed in this report including: the number of borrowers and per capita borrowing as indicators of market activity; loan usage as an indicator of P2P lending’s contribution to the real economy; average lending rate as an indicator of financing cost; and individual attributes as an indicator of the overall credit status of the borrowers.

It is worth mentioning that development of the P2P industry has led to the emergence of a number of derivative models, e.g. P2C (person to company), P2B (person to non-financial institutions), P2N (person to multiple organizations) and P2G (person to government). The first three models further segment existing borrowers into sub-groups, while the last, P2G model, is still at an early stage and lacks sufficient data for meaningful discussions. Therefore, we have limited the scope of our study to the mature business model, peer-to-peer lending.

(1) **Number of borrowers**

According to transaction data samples collected by Wangdaizhijia from 90 P2P platforms in 2013, an aggregate total of 149,300 borrowers completed P2P transactions that year, an 8-fold increase from 2012. The rapid increase continued into 2014 – statistics of Wangdaizhijia revealed that, as of the end of 2014, the total number of P2P borrowers hit 630,000, and the figure has kept growing. It is fully illustrative of the potential of the P2P industry as a fast-growing business. Specific data are presented in the table below:

![Figure 3.3: Increase in the total number of P2P borrowers](source: Wangdaizhijia.com)

(2) **Per capita borrowing**

Statistics released by Wangdaizhijia show that the per capita amount of P2P borrowing (total borrowing / No. of borrowers) was RMB 401,200 in 2014. Our calculation is based on data retrieved from the top-20 domestic platforms (by transaction volume) as of 14 January, 2015. Details of per capita borrowing are presented in the table below:
Fig: Per capita borrowing of top-20 Chinese P2P platforms with the largest transaction volumes (16.12.2014 – 14.1.2015)

Unit: RMB 10k / person

<table>
<thead>
<tr>
<th>No.</th>
<th>Company</th>
<th>Transaction Vol</th>
<th>No. of borrowers</th>
<th>Borrowing/capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Hongling Capital</td>
<td>300400.7</td>
<td>3,944</td>
<td>76.17</td>
</tr>
<tr>
<td>2</td>
<td>Lufax</td>
<td>137249.8</td>
<td>24,984</td>
<td>5.49</td>
</tr>
<tr>
<td>3</td>
<td>PPmoney</td>
<td>130908.5</td>
<td>5,506</td>
<td>23.78</td>
</tr>
<tr>
<td>4</td>
<td>Wzdai</td>
<td>85151.09</td>
<td>447</td>
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</tr>
<tr>
<td>5</td>
<td>Weidai</td>
<td>83249.6</td>
<td>11,550</td>
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</tr>
<tr>
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<td>Xinhehui</td>
<td>78056.2</td>
<td>1,324</td>
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</tr>
<tr>
<td>7</td>
<td>Yooli</td>
<td>71966.11</td>
<td>2,885</td>
<td>24.94</td>
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<tr>
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</tr>
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<td>15.92</td>
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<tr>
<td>10</td>
<td>Renrendai</td>
<td>56975.58</td>
<td>9,280</td>
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</tr>
<tr>
<td>11</td>
<td>Srong</td>
<td>54671.62</td>
<td>452</td>
<td>120.95</td>
</tr>
<tr>
<td>12</td>
<td>Yirendai</td>
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<td>11,316</td>
<td>4.83</td>
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<tr>
<td>13</td>
<td>Xiangshang360</td>
<td>46872.32</td>
<td>30,497</td>
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<tr>
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<td>Edai</td>
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<td>18</td>
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</tr>
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<td>20</td>
<td>Tuandai</td>
<td>32127.43</td>
<td>379</td>
<td>84.77</td>
</tr>
</tbody>
</table>

Source: Wangdaizhijia

As shown above, the amount of per capita borrowing varies greatly from platform to platform. Average borrowing on most platforms is found to be under RMB 300,000, whereas per capita borrowing exceeds RMB 1mn in the case of QianBaBa, Wzdai and Srong – in particular, QianBaBa loans average nearly RMB 3mn per capita. Such variations are primarily attributable to the different business models adopted by the platforms.

The unsecured P2P lending model represented by Renrendai and Lufax manages risks through investment diversification; car mortgage oriented financing platforms such as Yiqihao and Helloan have relatively higher per capita borrowing due to enhanced credit protection (i.e. mortgage); enterprise financing platforms represented by Hepai Online have greater financing demand than personal financing platforms with its per capita borrowing averaging RMB 1mn.

(3) Loan usage

The rapid growth of P2P lending is a manifestation of deficiencies in the existing financial system and also helps individuals and small businesses solve funding issues to improve life quality and business development. By analyzing loan usage, we can acquire an understanding of P2P’s contribution to the real economy and the development prospects of the P2P industry. Next, we make a specific analysis taking Renrendai as an example:
As shown above, 61% borrowings for short-term working capital and business financing purposes are spent in activities contributing to economic growth, with the rest expended to improve quality of life.

(4) Lending rate

Lending rates reflect the cost of financing incurred by borrowers. P2P lending rates are evidently higher than bank loan rates due to typically lower borrower credit ratings, less effective credit enhancement tools and inadequate information disclosure. Wangdaizhijia data show that weighted lending rates of mainstream P2P platforms ranged between 15% and 20% in 2014, and the average weighted lending rate in the industry was 17.86%, with the loan term averaging 6.12 months. For the sake of clarity, with a gross generalization, monthly weighted P2P lending rates are regarded as 6-month bond rates in our analysis, and they are compared with the 6-month benchmark lending rate and 6-month Shibor as follows:
As shown in the table above, P2P lending rates continued to fall since February 2014 at a monthly rate of 56bps, and hit a trough at 16.08% in December. We believe that this trend can be explained by the following phenomenon: After P2P platforms “fled” the market, investors became more risk averse and they started to allocate investments with older and less risky platforms, versus those promoting higher returns. As information asymmetry increased and competition intensified amid macroeconomic corrections, interest rates embarked on a downward track and the risk premiums of P2P lending projects dropped.

(5) Borrower attributes

This study analyzes different attributes of borrowers on the following dimensions: gender, age, marital status, education and location:

1. Gender ratio

According to 01caijing, male borrowers currently account for the majority (78%) of the total. We believe this is due to the fact that a considerable proportion of the borrowers are business owners, most of whom are men. Additionally, male borrowers also account for the majority of home and car upgrade financing loans, indicating that there is significant potential to develop women borrowers as a market segment.

2. Age structure

Our analysis covers 55,264 borrowers from 11 platforms:

As shown above, the majority of the borrowers are aged 20-49. This segment includes young entrepreneurs, as well as business owners seeking working capital funding. Borrowers in this age group have the most urgent need to improve their quality of life. Overall, the age breakdown matches our findings about loan usage.
3. Marital status

Marital status is one of the key indicators in banks’ personal credit assessment system. Married borrowers are believed to have a stable life, and they are therefore assigned a favorable rating in credit assessments. According to 01caijing’s statistics involving 51,160 borrowers from 11 platforms, this is also true of P2P borrowers, where 71.82% of them are married, with widowed and divorced borrowers accounting for less than 10%.

4. Education

Education related statistics mainly cover 50,925 borrowers from 10 platforms:

As shown by the statistics above, people with university or advanced degrees do not account for a large proportion (only 24%) of P2P borrowers. This is likely due to the fact that highly educated people are more likely to obtain funding from traditional financing channels, especially in terms of consumption for quality of life improvement. On the other hand, people with medium/low-level education are more inclined to be self-employed or start their own businesses.

5. Location

Chinese P2P platforms are still accustomed to conducting business expansion from their headquarters. As a result, there is a clear correlation between the geographic distribution of borrowers and that of the platforms, concentrating mostly in developed coastal regions such as Shanghai, Shandong, Zhejiang and Guangdong. Based on statistics involving 31,885 Renrendai borrowers, their location distribution is outlined in Fig. 3-9.
3. Investor profile

(1) The number of investors

The number of P2P investors began to increase rapidly from 2012 onward. As of the end of 2014, the number of investors reached ~1.16mn, 22.7 times higher than that in 2012. Factoring in the possibility of double counting between the platforms, the actual number of P2P lending investors is conservatively estimated to be ~600,000.
(2) Per capita investment and investment structure

According to statistics released by Wangdaizhijia, as of the end of 2014, an aggregate of ~RMB 382.9bn had been traded in the P2P industry, of which RMB 252.8bn was processed in 2014, an 11.9-fold increase from 2012. P2P investors totaled 1.16mn in 2014, with per capital investment averaging RMB 217,900, lower than that in 2012 (RMB 410,000) and 2013 (RMB 420,000), indicating a sharp rise in the number of small lenders.

A breakdown of P2P investments reveals that, in 2014, the majority (63.74%) of P2P lenders invest a monthly amount of less than RMB 10,000 in a single platform. We found that the higher the value of investment, the fewer number of investors – lenders investing RMB 1mn or more only account for 0.36%, and some of them are institutional investors.

(3) Investor attributes

According to an online sample survey conducted by Wangdaizhijia in 2014, 85% of the P2P lenders that responded in the survey were men, and only 15% were women, meaning there is plenty of room to tap into female investors as potential P2P lenders.

![P2P investor gender ratio](image)

**Fig. 3-12: P2P investor gender ratio**

**Source:** Wangdaizhijia.com

In terms of investor age structure, statistics from Wangdaizhijia indicate that investors aged below 19 account for 1.32% of the total, while those aged 20-29 account for 40.46%, 30-39 for 40.13%, 40-49 for 14.84%, and those older than 50 for 3.29%. Hence, most (more than 80%) investors are young adults aged 20-39. This means that as a new investment model, P2P lending is more readily accepted among young people who also tend to have a higher level of risk tolerance. Nonetheless, the latest research findings suggest that senior people aged above 50 with stable incomes are also growing into a main force for P2P lending, thus this demographic is expected to increase its participation in the P2P market when it becomes mature.

From a geographic point of view, Guangdong and Zhejiang rank as the top-2 locations with the largest concentration (18% and 11%, respectively) of P2P investors, followed by Shanghai, Jiangsu and Beijing (8-9%). Virtually none of the investors are based in Xinjiang, Inner Mongolia or Qinghai. The number of investors by location is found to be positively
proportional to local economic output. The more developed the local economy, the more money for local residents to invest.

According to statistics released by Wangdaizhijia in 2014, the average yearly income of P2P investors was ~RMB 110,000. Specifically, 25% of the investors had an annual income of less RMB 50,000; 35% earn RMB 50,000 – 100,000; and 25% earn RMB 100,000 – 200,000, making a combined total of 90% of all investors.

Low/medium-income earners have become the main force of online investment. This is a manifestation of the absence of low-barrier and high-return investment channels on the market and the fact that P2P platforms offer convenient access to investment and wealth management for the low/medium-income class.

4. Status quo of P2P lending platforms

Due to the lack of existence of industry regulation policies, the P2P lending industry is currently in a state of spontaneous development, driven by market forces. Despite the exposure of problems with the P2P model and the increasing number of “missing” platforms, the P2P industry is still growing at a rapid pace thanks to the growing popularity of the Internet and the strong demand for private lending.

In addition, the development of P2P platforms is characterized by the following trends: Annual growth of platforms is stabilizing due to a constant process of “survival of the fittest and elimination of the unfit”; and a number of reputable national P2P platforms of scale have emerged on the domestic market.

(1) Development of platform companies

Judging by capital strength, 36 domestic P2P platforms had registered capital of above RMB 50mn (inclusive) as of the end of 2013. At the end of 2014, this figure increased to 54, of which 22 were incorporated in 2014. Of them, Lufax ranked at the top of the list with registered capital of RMB 836.67mn.

In terms of assets under management, as of the end of 2014, 96 P2P platforms had cumulative outstanding loans worth more than RMB 100mn. Five of them had outstanding loans worth more than RMB 500mn and 13 more than RMB 1bn. The top-3 platforms were Lufax, Hongling Capital and Renrendai with their respective outstanding loans totaling RMB 9.412bn, RMB 6.694bn and RMB 4.186bn. Of the 96 platforms with outstanding loans worth more than RMB 100mn, 27 started operations within the last 12 months. Of the 27 platforms with outstanding loans exceeding RMB 500mn, only 4 (Jinxin99.cn, Xinhehui.com, Imzhongxin.com and 5djbb.com) had been in operation for less than 12 months.

In terms of leverage (ratio of registered capital to outstanding loans), 73 platforms had 10X or higher loan leverage, 42 reached 20X, and seven of them exceeded 100X leverage, including Eloancn.com (2258X), Itouzi.com (653X), Xiangshang360.com (264X), Niwodai.com (251X), Yirendai (235X), Yooli.com (207X) and Hongling Capital (144X).

Seeing the enormous market volume, various private capital firms have invested in P2P businesses through equity contribution, controlling interest and acquisition. According to incomplete statistics as of the end of October 2014, a total of 30 P2P platforms had attracted more than RMB 3bn worth of investment each.

Triggered by SBCVC’s investment in Yooli at the end of 2013, publicly announced VC deals have been carried out at a dizzying pace during the last year or so. The three biggest deals
were EZCapital taking over Renrendai at a price of US$130mn; Sequoia Capital becoming a shareholder of Ppdai with a US$50mn investment; and Morningside Ventures investing US$50mn in Yooli.

Putting venture capital aside, banking capital, SOEs, listed companies (excluding the aforementioned 3 types of capital operators (i.e. VC, bank and SOE)) and private capital (excluding the aforementioned 4 types of capital operators) have also been stepping up efforts to enter the P2P lending industry. In early 2014, numbers of P2P platforms set up by banking capital, SOEs, listed companies and VC companies were merely 3, 1, 3 and 6, respectively, which jumped to 12, 17, 17 and 29, respectively by the end of the year. Although they accounted only for 0.8%, 1.1%, 1.1% and 1.8%, respectively, of the total number of platforms, their contribution to the total value of outstanding loans reached 12.5%, 2.8%, 1.5% and 18.2%, making them heavyweight players in the P2P industry.

Judging by the geographic distribution of the platforms, there is a direct correlation between the number of local platforms, local economic development, and private lending activity. According to statistics released by Wangdaizhijia, as of the end of 2014, the Guangdong Province had the largest number of P2P platforms (349), followed by Zhejiang (224), Beijing (180), Shandong (149), Shanghai (117) and Jiangsu (104). Relevant details are outlined in Fig. 3-13.

![Fig. 3-13: Geographic distribution of P2P platforms in 2014](image)

According to incomplete statistics, as of the end of 2014, an aggregated total of 367 platforms had recorded problematic incidents, most of which occurred in 2013 and 2014. Furthermore, the situation is spreading and deteriorating further.
Most of the “problematic” platforms concentrate in Guangdong, Zhejiang and Shandong. Collectively, they account for 48.6% of the national total, which is slightly higher than the proportion of the number of local “normal” platforms to the national total. As shown in Wangdaizhijia statistics, P2P platform-related incidents have never occurred in Shanxi, Ningxia, Heilongjiang and Xinjiang; while Yunnan, Liaoning and Beijing have the lowest P2P incident rates at 7.1%, 10% and 10.2%, respectively; Gansu and Hainan have the highest platform incident rates (above 50%), but these results may be coincidental, as there are relatively fewer platforms in these two provinces. Our findings show that incident rates are all above 23% in Hunan, Hubei, Anhui, Shandong and Shanghai, where there are a larger number of platforms. It even reaches more than 36% in the case of Hunan and Hubei, a sign that the local P2P lending markets are in a poor state and have significant risks.
(2) Platform products

As for product origination, P2P platforms typically determine product prices, loan rates and maturity taking into account borrowers’ actual needs, credit status of individual borrowers, platform operations and local interest rates. Given the large number of platforms in China, their businesses are clearly differentiated from each other, as are their products. Consequently, it is difficult to establish a set of uniform criteria to generate meaningful statistics.

In 2014, the PBoC and the CBRC separately made it clear that P2P platforms should be positioned as information intermediaries. Since then, mainstream P2P products have been standardized to the extent that they are defined as assets reflecting actual lending relationship. The platforms usually list assets approved by them on their websites, waiting for investors to put in bids. When the aggregate investment amount reaches the listed amount, the auction is successfully fulfilled, the lending relationship established and the contract comes into effect; on the other hand, where the listed amount is not reached within the prescribed time limit, the borrower’s listing is cancelled and the contract becomes null and void. The borrower and lenders may apply for other options.

Such an approach is prone to auction abortion and indeed requires very close attention from both parties. In an effort to make the process more convenient and improve user experience and borrower-seller matching efficiency, several major P2P platforms rolled out wealth management products based on automatic matchmaking. These products enable investors to make bids at will, and interest accrual commences once the listing amount has been fulfilled, similar to the model of wealth management products offered by banks. This way, the efficiency of borrower-seller matchmaking is substantially enhanced. That said, with a lack of transparency in the transaction, it may lead to breaches of the ban on “capital pooling”.

Some platforms also developed a secondary market dedicated to their own products in a bid to increase product and debt liquidity, allowing creditors of outstanding loans to trade remaining debts publicly for early investment recovery. In the case of some popular platforms, about half of the listings are highly sought-after and most investors lose out in bidding for them. Hence, purchasing “second-hand” listings has become a common practice in the P2P industry. The average time of auction fulfillment on major Chinese P2P platforms is listed as follows:

<table>
<thead>
<tr>
<th>Listing</th>
<th>Platform</th>
<th>Transaction volume</th>
<th>Loan auctions</th>
<th>Time needed for auction fulfillment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Hongling Capital</td>
<td>568183.08</td>
<td>132374</td>
<td>35.922min’</td>
</tr>
<tr>
<td>2</td>
<td>Lufax</td>
<td>326883.94</td>
<td>57881</td>
<td>0sec</td>
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<tr>
<td>3</td>
<td>PPmoney</td>
<td>178952.54</td>
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<td>Xinhehui.com</td>
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<td>Weidal.com.cn</td>
<td>155442.09</td>
<td>22174</td>
<td>1.245h</td>
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<td>Renrendai.com</td>
<td>103164.54</td>
<td>16809</td>
<td>18.369min’</td>
</tr>
</tbody>
</table>

Fig. 3-16: Number of listings and auction fulfillment time at top-10 Chinese platforms by transaction volume from 2014 11 1 to 2014 12 31

Source: Wangdaizhijia.com
(3) Platform risk status

1. Borrower-related risks

(1) Credit risk. China has a poor credit environment and an underdeveloped personal credit system, meaning the cost of default is very low for debtors, and debt collection is difficult on the part of creditors. With P2P lending as a virtual financing business conducted online, it is exceedingly difficult for lenders to protect their rights and interests.

(2) Revolving lending. Many platforms permit lenders to take out loans using their existing creditor’s rights as security. This actually creates financial leverage similar to the bank deposit reserve mechanism. Lenders may lend out their funds on the platforms as an investment, and take out loans secured on their existing debts, aiming for arbitrage profits through revolving lending. By leveraging themselves up, lenders run into increasing risks of default.

2. Platform-related risks

(1) Risks associated with fund management. At present, lenders and borrowers’ funds on most P2P platforms are directly credited into or withdrawn from their accounts within the platforms, without setting up any escrow accounts. Such a situation entails the risk of funds being abused or misappropriated, as well as substantial risk of “self-financing” and “false financing”. Thus far, only a limited number of P2P platforms (e.g. Gkkxd.com) have collaborations with banks in place to enable investors to directly transfer funds into and out of their bank accounts through online banking, thereby preventing mixing investor’s money with the platforms’ own funds.

(2) Risks associated with credit checks. Many P2P platforms do not have specialized risk controls and credit check teams. Their lender qualification checks are lacking in sophistication and limited to the traditional microloan credit model. Therefore, there is a potential risk of bad debt prevention failures.

(3) Operational risks. In a bid to increase liquidity for lenders by matching yields with loan maturities, many platforms develop capital pooling through loan splitting, on the verge of breaching the PBoC’s “three bottom lines”. A single lag in short-term cash flow may lead to breakage of the funding chain and ultimately force the platform into bankruptcy. Many platforms have extremely high leverage, in terms of limited registered capital relative to total borrowing. In the event of loan splitting through capital mismatch or a major loan delinquency, these platforms would be prone to funding chain breakage as their funds start to drain with investor withdrawals.

(4) Information safety risk. Some P2P platforms – particularly those “missing” platforms – bought “semi-finished” websites directly from third-party companies developed with open source codes, and even outsourced website backend operations to third parties, resulting in exposure of company and user information. In the case of a website access technical issue, the resulting psychological impact on investors may spark a run on the platform due to information asymmetry.
Section 2. Marketing Management Analysis

1. Development history

Private financing has a long history of development in China. Mobile Internet grew rapidly in the country as market penetration of 3G and 4G services increased, and mobile marketing has become a key growth factor driving market activities. This presents great opportunities for the P2P industry, injecting fresh impetus into the private lending business. Furthermore, young people accept new things more easily and have a general tendency toward consumer finance services. They are willing to try ever-evolving online wealth management and financing services. For example, statistics released by Wangdaizhijia show that on the Single’s Day of 2014, total P2P loan transactions in China hit RMB 2.408bn, a 72.78% increase from the previous day, with an overall yield of 16.48%.

Evolving from online lending businesses during early development stages, the P2P industry presently offers highly diversified financial asset transfer services applying a cross management mechanism combining online bidding with offline marketing. In terms of marketing techniques, P2P lending operators attract investors mainly through cash back offerings for newly registered bidders, “seckilling” bidding and short-term high yields.

Development of P2P marketing models went through three stages: (1) 2006-2007 – business models were established, such as offline marketing of CreditEase, and purely online marketing of Ppdai; (2) 2008-2011 – initial market promotion, such as B2C financing marketing, vertical financial search engine and the Lufax platform; (3) 2012-present – large-scale growth of the industry, such as specialized channel marketing, marketing based on big-data mining and cross-financial-market penetration marketing.

Judging by current developments and our outlook for the near future, P2P marketing will shift from homogeneous development toward precision marketing, thereby enhancing interactive communication services and after-sales services for private investors and “fundraisers” (borrowers). New marketing models based on transactional financial assets will emerge and gain in popularity. In addition, many P2P companies will go through a major reshuffle, and most “less serious” companies will be eliminated.

2. Type analysis

For a clearer understanding of the marketing models in the P2P industry, we focus our analysis on the following four marketing operations:

(1) Online marketing

Some P2P companies consolidate and integrate private investors’ lending and asset allocation needs via the Internet, and match them up with fundraisers’ financing and asset disposal needs, providing integrated information platform services to increase the stickiness of clients at both ends. This marketing model represents an innovation mainly in terms of grasping the psychological needs of the users. It highlights user-friendliness, navigation by users’ needs, well-defined management modules, payment convenience and security and information transparency.

Specifically, P2P platforms attract investors through registration rewards, “seckilling” offers for beginners, cash back for credit purchase, public bidding and asset transfers, using competitive returns on investment and sound risk management performance as key selling points. For fundraisers (borrowers), P2P platforms offer cost-effective differential risk pricing, flexible repayment mechanisms and financing rate discounts, maximizing appeal through convenient financing approval procedures and a highly interactive financing process.
Needless to say, the impact of Internet financing on the P2P industry is reflected primarily in terms of online marketing innovations, which greatly improve the efficiency of resource allocation, which is otherwise conducted point-to-point, and increasing the activity of private financing markets. Representative platforms include Ppdai, Dianrong and Renrendai.

(2) Offline marketing

Some P2P companies match the investment needs and funding needs and asset allocation transactions between investors and fundraisers (borrowers) through non-Internet channels, and need to incorporate financing information transparency and asset-liability management services into this process.

The fact remains that most P2P companies rely on an online-marketing-oriented model, but do not rule out offline marketing, which typically has better delivery performance and market penetration, but entails larger marketing costs. A growing number of P2P companies have become aware of the benefits of the O2O model, in terms of improved market impact, marketing service standards and user experience, enabling them to identify prospective clients more rapidly and in a more sustainable fashion.

Therefore, the key factor in offline marketing lies in the effectiveness of online services. The operating model may be developed building on that of chain stores, with basically two options available, i.e. proprietary business outlets and franchise. The core priorities are to acquire first-hand information and expand the base of qualified investors and fundraisers (borrowers). Specific marketing techniques typically include branded advertising, financial consulting and counseling. CreditEase, Zendai Wealth Management and Renrenmoney are representative examples of this marketing model.

(3) Third-party partnership

Some P2P companies expand client acquisition channels in partnership with third-party organizations including portal websites and micro-finance and guarantee companies, increasing business bundling and creating effective division of labor throughout the industry chain. Compared with pure online-and-offline marketing models, a model involving third-party collaboration enables P2P firms to benefit from the “catfish effect” over partners’ client inventories, tapping into the complementary demand of both parties by providing convenient financial services with comparatively transparent information disclosure and cost-effective fundraising mechanisms. This way, P2P platforms can rapidly accumulate prospective investors and fundraisers (borrowers) interested in the P2P business.

Specific marketing techniques of this model mainly include SOE credit guarantee, financing project referral and financial search engines, and representative platforms are Gkkxd, Yooli and 91jinrong.

(4) Marketing through resource integration

By integrating internal resources and external social resources, some P2P companies develop cross-sector marketing networks, and effectively match the needs of a vast number of investors and fundraisers (borrowers) employing big data mining and precision marketing techniques. This model is usually adopted by large conglomerates with existing channels for multiple financial services or cross-industry consumer service platforms. Having acquired certain “Internet genes”, these conglomerates reinforce internal-external resource integration on the basis of existing consumer bases and client acquisition channels, so as to build up on their P2P profit models and growth drivers.
Compared with regular marketing models, marketing initiatives based on resource integration have a bigger impact on the marketplace and communicate a stronger call to action. They increase the depth of end-user services offered by P2P companies, thereby creating a “one-stop” shopping experience for the users. Admittedly, resource-integration marketing operations at Chinese P2P companies are still at an early stage and a mature business model has not yet been established, but cross-sector resource integration may be realized in the future.

Specific marketing techniques of this model mainly include integrated promotions, inclusion of wealth management, cross-platform credit assessment and customized precision marketing. Representative platforms utilizing this model are Lufax, Ant Financial and 8.baidu.com.

In addition, we have seen an increasing number of cases of banks, insurance firms, funds and brokerage houses joining this marketing network and carrying out cross-industry collaborations with P2P companies. Capital markets and venture capital firms also seeking suitable investment targets for pipeline building.

3. Characteristics

(1) Multiple marketing channels

Acutely aware of the rare growth opportunities, many P2P companies set up highly diversified business collaboration models based on the advantages of their respective resources and technical platforms. They steer marketing inputs toward the construction of various differential channels for client acquisition, e.g. Internet portals, micro-finance loan providers, guarantee companies, media channels, third-party payment service providers and large ecommerce platforms.

(2) Market dynamics

In the face of systemic barriers to market-based microbusiness financing, it is imperative to diversify financing channels through innovative development. This provides P2P companies with an opportunity to enhance market dynamism through marketing initiatives. We can see that companies have been actively building brand competitiveness through marketing, credit resource enhancement and high-quality project sourcing, consistently innovating product coverage and content, and matching financial needs with increasing precision.

(3) A trend toward wealth management products

Given the accelerating pace of interest rate liberalization, the general public is most interested in high-yield wealth management products. In response to this, P2P companies usually adopt a fundraising approach similar to that of wealth management products offering categorized investment modules based on refined user needs to attract more investors. For borrowers, separate solutions are provided for consumer finance and industry financing clients, thereby increasing the appeal of their funding services on the marketplace.

(4) A shift toward online services

With commercialization of 4G technology, more and more mobile Internet applications have been created. P2P companies also expanded marketing networks to this area, amid a shift towards online services. In addition to explorations in cyberspace, some P2P companies expanded their offline networks to include markets in underdeveloped areas. This will definitely help ease funding difficulties for microbusinesses in central and western regions, as well as being a step forward to creating a high standard service network.
4. Existing issues

(1) Homogenous marketing models

The majority of P2P companies are still prioritizing new customer acquisition (i.e., growth of registered users) over customer loyalty (or stickiness) as the core component of their marketing models. Many companies are fond of highlighting average return performance at the most prominent position on their homepage to attract more investors. In fact, this is a double-edged sword – it may breed a high-yield obsession among investors at the cost of underestimating risks. It may also cause adverse selection and moral hazards among borrowers, i.e., turning borrowers away due to concerns about excessive funding costs.

(2) Inadequate big data use

Most P2P companies look at big-data mining capacity building as a key to technical competitiveness and have created a set of effective marketing and credit assessment reference data by analyzing users’ needs and risk characteristics. However, relative to the amount of information disclosed on existing platforms, only a limited amount of user-related big data have been mined, used, analyzed, or shared in the entire P2P industry. This is particularly true of credit mechanism building, which happens to be a critical factor safeguarding the overall marketing service quality in the P2P industry.

(3) A bias toward lenders, against borrowers

When a new P2P platform is launched, fund raising is usually the biggest concern. Companies need to attract a maximum number of investors, with reliable return on investment. As a result, marketing and financial investments are primarily focused on lender acquisition. This leads to general negligence of the needs on the borrowers’ end, compromising project quality requirements for the sake of traffic maximization. In fact, a sustainable supply of high-quality fundraisers (borrowers) is the foundation for the lasting development of P2P platforms, and more value may be created by investing marketing efforts in building the borrower base.

(4) Vicious competition

Given the relatively low entry barriers of P2P lending in China, there has been a certain degree of degeneration among the Chinese P2P industry, with vicious competition and frauds occurring from time to time. Varying qualifications of P2P platforms have led to deteriorating conditions for P2P marketing operations, and effective self-discipline is urgently needed.
Section 3. Credit Management Analysis

1. Development overview

The P2P industry is still primarily oriented toward credit management related financial services. Development of credit management models can be generally divided into two phases. Phase one is the establishment of models where the underlying credit management framework was created with an orientation toward the funding needs of microbusinesses and consumers. Capital pools were set up at scale and coupled with investment and financing maturity mismatch smoothing. Policy risks remained at work and were manifested with a number of platform “fleeing” incidents.

Phase two is the development of standardization with the establishment of a complete set of risk control mechanisms and strategies, accumulation of credit data and social media information, formulation of guarantee resources, product pricing and market development standards and the creation of the self-discipline mechanism, which provides guidance for regulatory policy formation.

Judging by product type, priorities in credit management mainly include microloans, consumer financing, industrial credit, financial product distribution, supply chain financing and large corporate loans.

2. Representative models

(1) Product development

Aiming to speed up project turnover, P2P companies focused on maturity matching for short-term products, mismatch for mid-term products and securitization asset pools in product development activities.

First, short-term financing products are developed with various maturities of less than one year to address the issue of short-term funding supplies. Loan periods include 1, 3, 6, and 9 months. Alternatively, borrowers are allowed to choose their preferred loan periods.

Second, for borrowers seeking mid-term financing with a maturity of longer than one year, investors are encouraged to commit to mid/long-term supply of capital based on the principle of maturity matching, or allowing maturity mismatches within a reasonable range to facilitate asset scale-up.

Third, on the basis of maturity matching, third-party asset transfer platforms are developed with a liquidity orientation according to clients’ requirements. Market-based interest trading channels with preliminary securitization asset pool mechanisms were established thereby providing basic institutional arrangements for the deal making business.

(2) Credit structure

As part of their financing risk control efforts, P2P companies gradually created credit systems structured in line with the different needs of different clients, mainly involving “full faith and credit,” collateral, surety bond on principal and insurance.

First, loans are granted to qualified short/mid-term borrowers on “full faith and credit,” or with the borrowers’ own accounts receivables as security. This streamlines the loan application process and therefore bolsters financing demand.
Second, for most corporate financing clients, funding is offered on third-party guarantees or collateral. Fundraisers (borrowers) are encouraged to provide counter-guarantee measures covering specific amounts to incentivize investors to provide wholesale funding.

Third, on top of the credit facilities mentioned above, P2P platforms usually also offer surety bond on principal, or insurance, with a specific ceiling and time limit, incentivizing investors with guaranteed capital safety.

(3) Funding price

In a bid to minimize financing costs, P2P companies typically employ credit-rating-based pricing, pricing through auction, and asset-pool credit risk pricing for financing products.

In credit-rating-based pricing, the lending rate range is determined according to the credit rating of the fundraiser (borrower). The higher the credit rating, the lower the interest rate floor. This pricing method is adopted by most platforms with relatively developed credit databases to drive down overall funding costs.

Pricing through auction refers to the process where investors make bids in auctions for financing project initiated by fundraisers (borrowers). Bidders offering the lowest prices are selected as project winners. If the target amount of a financing project is successfully raised within the time limit specified, the loan contract is then concluded. This model is mainly applied in certain traditional P2P platforms. It helps the market identify the suitable price point and guide the seller and buyer to achieve balance in demand and supply.

Asset pool risk pricing involves the platform company raising capital from investors in graded and categorized financial management packages in line with the project’s overall maturity and interest frameworks, with an asset pool of fundraisers (borrowers) serving as the pledge. To a certain extent, the platform plays the role of a financing information matchmaking intermediary with a credit assessment function.

(4) Guarantee resources

In order to enhance credit quality, P2P companies offer multiple resources in terms of external cooperation, supplementary compensation and introduction of market-based instruments to tackle the credit bottleneck to platform development:

First, the platform company engages in partnerships with external guarantee organizations, including micro-finance companies qualified as guarantors, to provide guarantee support for financing projects on the platform. In a bid to fully tap into the “blue sea” market, some platform companies provide industry chain financing services targeting upstream and downstream small businesses revolving around large enterprises, with external guarantees and benefit sharing offered by those large enterprises. A relevant example of this approach is “Xiaocunzhe” (www.xiaocunzhe.com), currently under preparation by Qingguo Financial Services.

Second, some platforms with external guarantee resource constraints provide supplementary compensation for the amount of losses resulting from credit risk (within a specified limit), offering guarantees mainly covering principal repayment. Such loss provisions are charged to the fundraisers (borrowers) at specific rates to create “quasi-margin” internal guarantee resources.

Third, insurance companies are actively experimenting with market-oriented credit instruments specially designed for P2P platforms, including traditional insurance products,
credit insurance and loan on policy products. Specifically, this involves capital safety insurance for investors, life insurance for borrowers, collateral insurance, credit insurance covering loan losses and allowing financing based on policy pledges. Relevant examples include credit insurances jointly developed by CreditEase and China Life Property & Casualty Insurance, and “Bao Xin Hui” launched by Gkkxd.com.

(5) Loan management

In order to optimize credit business processes, P2P companies adopt loan management approaches such as outsourcing to professional organizations, internal management and market-based self-help management, among others, to fully optimize entire loan management procedures.

In order to improve platform operating efficiency and realize specialized division of labor, many P2P platforms opt for outsourcing pre-lending information verification, post-lending management and collections to micro-finance companies, guarantee providers and professional post-loan management companies. This practice forms interest binding and sharing relationships, and reduces management costs.

In the case of P2P platforms which have acquired competitive operating and risk control capabilities, they build up their own professional competence in credit strategy, risk control review, lending decision making and post-lending management. This minimizes operating costs and optimizes management operations through big data and high-tech applications and specialized risk control systems.

P2P platforms also employ the market-oriented, self-help management model for highly segmented online micro-financing projects. For example, self-help pre-lending check, post-lending management and auto repayment mechanisms similar to credit card overdraft processing are adopted for consumer finance loans to optimize financing matchmaking efficiency.

3. Characteristics

(1) Product diversity

The P2P industry currently displays a high degree of innovativeness in product development. The market is at an initial stage of differentiating competition. Leveraging the Internet, P2P platforms channel funding resources in eastern regions to central and western China, optimizing financial resource distribution. As a result, many products are of a multifunctional nature and designed to address financing demand, as well as fulfill wealth management goals, strengthen systemic resource matching and improve comprehensive service functions (including consumer, corporate, rural, microbusiness, instrument-based and equity financing).

(2) Broad management coverage

P2P lending has a broad industry reach, in keeping with its positioning as an information intermediary service. Lending activities are classified into different management layers according to regional market characteristics, integrating the needs of both investors and fundraisers (borrowers) into platform services. Platforms relying mostly on offline marketing and post-lending management outsourcing will require increased management layers involving the creation of highly efficient, streamlined mechanisms for information verification, integration, processing and mining, allowing the platforms to enhance user experience responsiveness.
(3) Demand diversity

Our demand analysis shows that diversity of market demand is one of the salient features of the current P2P industry. Instead of being limited to “sunshine” financing within traditional private lending projects, market demand has been diversified in terms of profit sharing from optimized financial resource allocation via the Internet (including mobile Internet), thereby removing the “inhibitory effect” on financial activities under the traditional financial regime. Diversified demand involves provision of mid-term micro liquidity asset allocation, financial asset portfolio diversification, reducing contract data exchange and transfer costs, and market-based interest rate pricing, etc.

(4) Increasing industry breadth and depth

Judging by the value creation along the industry chain, the breadth and depth of the P2P industry have continuously increased, marking a shift from purely lending-driven business models to the inclusion of asset businesses such as trusts, instruments, and insurance and equity funds. For example, 91wutong.com specializes in trust asset refinancing, a case of natural evolution based on the “point to point” nature of P2P lending in the distributed network environment.

In addition to horizontal expansion, the P2P industry also witnessed continued expansion in the depth of the product value chain, with differentiated product solutions created by optimizing maturity flexibility, packaging categorization, collateral and market transfer transactions. This allows P2P platforms to better accommodate borrower and lender needs for funding matchmaking.

4. Existing issues

(1) P2P’s contribution to the real economy remains to be improved

Without offering concrete support to the real economy, financial innovations would be reduced to a “distant mirage” of little practical significance. Thus far, P2P platforms are only capable of conducting relatively superficial analyses of the organic growth and market development trends in real economic sectors serviced by them. Such analyses are lacking in forward-looking vision and offer limited value for risk prevention, rendering them ineffective in terms of providing guidance for investors. A substantial reduction in the cost of P2P funding is unlikely to occur over the short run, which, coupled with a rather extensive management approach, considerably reduces the P2P industry’s contribution to the real economy. Consequently, the P2P market has been undervalued by investors, and companies alike.

The P2P industry offers cost-effective financing for small businesses. Nonetheless, given their inherent need to attract more investors, P2P companies have a general preference for high-yield projects, making them less effective as a source of low-cost funding. In this respect, the actual value of P2P lending relative to existing traditional financing models still remains to be observed and disclosed.

In terms of matching capital demand with supply, the real economy is most concerned about capital efficiency and funding price. However, P2P companies generally prefer consumer finance and secured loans over credit financing due to the latter’s tendency to arbitrage trading. As a result, they have failed to deliver highly effective credit financing support for real economic growth so far.
(2) Less transparent use of funds

Looking at the entire credit management process, issues regarding transparency in using P2P funding capital can be outlined as follows:

1. Inadequate information disclosure – Regular disclosure of annual and quarterly reports is marred by the absence of information disclosure standards at the level of specific items. A complete system has not yet been established to allow direct risk information screening by investors themselves, meaning effective guidance and monitoring on fund safety and transaction transparency are still not in place.

2. Unclear capital movement – It is a normal requirement that funds should be transferred directly from the investor’s account to the borrower, but the truth remains that some companies are still using the capital pool model in disguise, making it impossible to track capital movements. Furthermore, even after funds have been transferred into the borrower’s account, platform companies are still unable to continuously track capital flow in the current system.

3. Unspecified sources of repayment – Despite relevant information being disclosed in the case of some P2P platforms, the majority of them still have not set up standards for regularly assessing, tracking and disclosing the sources of funds for loan repayment on the part of fundraisers (borrowers). Hence, the investors do not have direct access or tools to judge and track the reliability of loan repayments they receive.

(3) Inadequate guidance on investor and borrowers’ requirement analysis

We need to provide guidance to the lenders and borrowers in analyzing their investment/funding requirements, so as to realize optimum resource allocation. Within the P2P industry today, strategic consideration is still lacking in terms of protecting investors’ principal, returns and capital safety. Given the general trend in the industry to “remove guarantee-reliance,” the attention of P2P participants should be steered toward long-term benefits, which is impossible because no innovative value or sustainable product security system have been created by P2P companies.

In addition, P2P platforms fail to sufficiently analyze borrowers’ control over financing costs. Instead, their work only revolves around risk pricing decisions based primarily on bad debt ratio as the core management indicator, rather than effectively reducing the cost of funding for fundraisers (borrowers) by expanding market-oriented financing channels and optimizing procedural management efficiency, thereby teaching borrowers to improve their behavior in borrowing, using, managing and repaying funds.
Section 4. Risk Management Analysis

1. Development overview

The P2P industry has achieved numerous breakthroughs and developed rapidly since 2006. During the intervening years, however, frequent bad debts and “runaway” incidents cast a shadow of uncertainty over the future of the P2P market. Some platforms have made steady headway and gained recognition in the capital markets, securing considerable financial backing, whereas some small P2P companies struggled to survive amid economic restructuring. Overall, the risk premium in the P2P market has been trending down and it is conducive to improving effective risk control. According to statistics released by Wangdaizhijia, P2P investors’ average return fell quickly from 21.63% in February 2014 to 16.3% in November, a sharp decline of 5.33% in merely 8 months. This followed the natural course of development, indicating that the standard of risk control had been steadily improving on P2P platforms, and it was gradually recognized by capital market players.

Development of P2P risk-control models is divided into two phases: (1) The initial development phase – A passive risk-control model characterized mainly by the reliance on internal and external guarantee resources; (2) The improvement phase – An autonomous risk-control model based principally on risk management approval rate, with risk control operations further developing into a risk engine strategy. This development follows the natural course of evolution and reflects the advanced requirement for risk control systems in Internet-based operations (i.e. platforms should acquire all-round risk management awareness and capabilities, rather than relying purely on external factors for risk control and prevention).

Going forward, the quality of risk management in a P2P company will be assessed in terms of its ability to enhance credit ratings, credit data collection, due diligence and potential risk event analysis, and its acquisition of relevant technologies. This would be in stark contrast to conventional thinking about risk control and traditional risk control models.

2. Representative models

(1) Rating methodology

A review of internationally accepted risk management paradigms for P2P lending shows that scorecard-based credit rating has remained a common approach to market-oriented risk control. There are slight variations between risk rating models adopted by different organizations. Specific rating factors include information about individual fundraisers, financial status, public and third-party credit records, risks associated with the industries concerned, social media behavior, purpose of funding, willingness to repay, credit structure, collateral and financial flows.

In fact, a risk assessment model allowing investors to make their own decisions has still not been created in the industry, and P2P platforms have been acting as information and deal-making intermediaries as well as risk-control decision makers taking the overall financing project approval rate as the major risk-control indicator. Therefore, in view of the ongoing big-data-driven transformation, the invention of an open credit rating model and database allowing investors to make autonomous decisions in P2P project risk assessment will prove a major boost to P2P industry development. In this respect, Sun Polly is in the midst of developing an open “pragmatic P2P wealth management risk assessment model for individual investors.”

It might be argued that P2P company rankings are what matters the most. However, they only reflect the overall quality of the companies’ information intermediary services, rather than the
level of risk involved in each individual financing project. The platform companies are not obliged to offer a joint guarantee. Even so-called AAA rated P2P platforms are unable to completely prevent loss-making in each investment made by investors. We should not confuse company rankings with risk assessment.

(2) Law of large numbers

As far as the insurance trade is concerned, the law of large numbers (LLN) is nothing new and has remained the cornerstone of the insurance industry over the past century. But the truth is that it does not offer any solution to systemic risk. A popular definition of the LLN is that transactions and product design should be carried out according to the principle of minimum probability of a risk occurring to ensure effective control over the actual losses, providing that there are a sufficiently large number of transactions or product participants.

Is the LLN as important for the P2P lending industry? Indeed, we have not reached a consensus on this. Some platform companies prefer mega financial deals to minimize the cost of offline marketing activities. However, due to the “point to point” nature of the P2P industry, cost and supervisory advantages of Internet finance in transaction, payment, information and data mining operations can be fulfilled only if risks are effectively spread over a vast range of geographies and industries.

Specifically speaking, the role and significance of the LLN can be observed on three dimensions:

1. A sufficient number of qualified fundraising projects is necessary to lower systemic risks associated with any individual mega funding deals (i.e. preventing the P2P platform from an instant collapse as a result of massive losses caused by such mega deals).

2. A sufficient number of investors should be attracted by adopting the diversified investment approach (i.e. investing in small amounts and over a large range of projects), spreading their investments over various projects on the platform following the “many-to-many” principle. The resulting “portfolio-based” risk management helps ease funding difficulties and reduce funding costs.

3. Leveraging big data mining and information matching technologies, effective deal-making should be achieved within the shortest timeframe when there are a sufficient number of P2P projects available, thereby reducing the cost of time for both parties as well as diversifying risk monitoring to a certain extent.

(3) Data mining

Today, we are all aware of the new methods and opportunities brought about by big data technology. P2P companies, in particular, are most interested in data mining as a critical risk management and marketing instrument. Well, what kind of data exactly do we need to excavate to enable effective risk management in the age of Internet finance?

First, instead of simply gathering, sorting and analyzing information, data mining mainly involves synthesizing fundraisers’ behaviors and risk factors associated with financing projects and uncovering/identifying major potential risk events or false information. This information then helps investors to make better investment decisions.

Second, the aim of data mining is to identify typical patterns in triggering potential risk events. It helps predict the overall credit capacity of individual fundraisers and prevent us from granting excess credit. This requires sharing fundraisers’ debt and credit records through close cooperation with credit authorities, industry associations, third-party organizations, etc.
Third, data mining should not be identified as simply the processing of existing data. Instead, it is designed to create new and valuable insights that inform risk pricing for individual fundraisers’ funding projects. This way, fundraisers can adapt their behaviors to lower financing costs, and information symmetry can be achieved and substantively improved, resulting in genuine reductions in online financial transaction costs.

(4) Guarantee rules

There is no denying that the Chinese P2P industry will continue to rely on guarantee resources in the near to medium term, in line with the current phase of credit system development in China. Hence, we need to set up a set of guarantee rules for P2P project risk management:

First, efforts should be made to push forward guarantee model specialization through market-based mechanisms – not only limited to risk provisions (or “margin”) charged on fundraisers, but various social organizations should be encouraged to provide guarantee resources or instruments compatible with “Internet thinking”.

Second, if guarantee resources are externally procured, P2P platforms are not the guarantors themselves and therefore cannot include guarantee coverage, pricing, internal procedures, counter-guarantee measures, debt collection mechanism, etc. in the relevant information disclosures.

Third, while attracting more guarantee resources through product innovation, online information intermediaries can be introduced to assimilate traditional guarantee firms, microloan providers, insurance companies and policy guarantee funds into the P2P lending system, ultimately leading to the establishment of a specialized Internet finance guarantee partnership network.

These three “rules” provide the foundation for speeding up the development of the P2P industry. Relevant explorations have already been carried out by some P2P platforms. They include Pingan Guarantee Co., Ltd. introduced by Lufax, GKKXD’s large guarantee company and micro-finance ecosystem, Yooli’s microloan guarantee partnership network and Zlot’s China Life property & casualty and credit insurance services.

(5) Credit enhancement

In addition to guarantee resources, P2P platforms can provide credit enhancement services through three additional means:

First, highly diversified credit enhancement tools should be developed in line with the characteristics of the Internet finance model, such as private fundraiser credit rating services and related collateral, investors’ accounts receivable as security (involving identity conversion to fundraiser), market-based asset transfer platforms, right to yields as pledges, financial assets as a mortgage and liquidity risk reserves.

Second, relevant industry associations should fulfill their roles, working toward the creation of shared credit databases to avoid vicious competition between P2P companies. A ban on sharing blacklists only leads to increased credit rating costs and opens up loopholes to deadbeats. Shanghai Internet Credit Service Enterprise Association, for example, is setting up a platform for credit information sharing.

Third, an open society-wide Internet finance credit system should be established. Unlike the PBoC’s traditional credit system, where only credit card and loan related information is
recorded, such an open credit system should include social media activities of individuals and enterprises, industrial and commercial administrative information, online financial transactions, adverse consumer records, and financing delinquency records, etc. For example, Shanghai Credit Information Services Co., Ltd., affiliated to the PBoC credit system, is constructing such an open platform – Network Financial Credit System (NFCS), but it remains to be further improved in terms of the efficiency and fairness of market-oriented operations.

3. Characteristics

(1) Guarantee-reliance remains prominent

At the operational level, risk management within the P2P industry is still reliant on guarantee resources. Having played an effective role in preventing uncertainties and risks during the initial development stage, the guarantee-reliant model also makes it impossible to reduce funding costs for fundraisers (borrowers). On the other hand, given the massive number of fundraisers (borrowers), homogeneous collateral alone are not sufficient to fully convince investors of the effectiveness of risk control in P2P financing activities. In addition, as the collateral cannot be examined completely, effectively and in a timely manner, it impairs the efficiency of Internet financial transactions. Guarantee resources serve to optimize this process.

(2) Centralized information processing

Throughout risk data collection, organization, analysis and mining operations, P2P companies attach emphasis to centralized information processing, so as to enhance business responsiveness and the overall efficiency of their risk decision-making systems. To this end, an integrated, uniform internal-external data processing platform is created, tracking real-time two-way transactions between investors and fundraisers (borrowers); and a strategic risk engine and rapid review mechanism are set up to enable centralized data exchange and matching for financing projects based on the risk assessment model and computation results, ensuring successful deal-making of funding projects.

(3) Development of systematic assessment

Recently, “runaway P2P platforms” have become a main cause of public concern. As well as spotlighting fraudulent practices in P2P lending for the regulatory bodies, the incidents also prompted players within the P2P industry to establish a credible market-oriented rating system within the shortest time possible. Viewed from the perspective of the overall risk management framework, expediting systematic rating in the P2P industry has become a key priority, but it should not be identified with general financial organization rating or credit rating. Instead, systematic rating involves measuring the efficiency of P2P platforms as information intermediary service providers, and evaluating information transparency, risk management standards, market-oriented pricing capabilities, credit enhancement techniques and capital.

(4) Resource sharing reinforcement

On the basis of reducing risk management costs for the entire society, a general consensus has been reached in the P2P industry to share blacklists, open up asset packages among P2P companies, participate in joint financing and exchange credit data. In fact, relatively thorough sharing of fundraiser (borrower) related information is already a reality, and this can be observed in cross-industry financial collaborations. Nonetheless, market players are still reluctant to share investor resources and even see them as the domain for competition. Such an attitude is actually detrimental to the industry’s growth as a whole. After all, nurturing
high-quality investors and fundraisers (borrowers) is a lengthy process and cannot be completed overnight.

4. Existing issues

(1) Vulnerable information resources and the absence of a risk management system driven by big data

1. A credible credit system is still non-existent in China. As one of the cornerstones of Internet finance, an effective credit system is definitely a crucial infrastructure to facilitate P2P industry development and achieve fruitful risk management. Considered the origin of “grassroots” finance, private lending has always remained a “shadow” trade, which is attributable to nothing other than the absence of a uniform, open and credible credit system. In view of this, the PBoC issued the Notice to Make Effective Preparations for Personal Credit Services in early 2015, calling on eight organizations including Tencent Credit and Shenzhen Qianhai Credit to make effective preparations for personal credit businesses, allowing them six months before officially launching marketed personal credit services.

2. Client materials, transaction information, credit and routine accounting records accumulated on P2P lending platforms have not reached the minimum threshold for meaningful results. Therefore, risk control is still dependent on offline risk management teams. In addition to high management costs, this means the quality of risk management operations still rests on the size and competency of the offline team.

(2) Inadequate investor protection

During China Payment & Clearing and Internet Finance Forum 2014, PAN Gongsheng, PBoC deputy governor, disclosed that the PBoC was leading the formulation of a set of guidelines for promoting the healthy development of Internet finance. The PBoC will develop the regulatory framework for Internet finance guided by the “moderate, categorized, coordinated and innovative regulation” principle.

The top priority is to reinforce consumer protection for investors. Relying on collateral and other traditional risk control measures may lead to certain adverse effects (i.e. “compulsory repayment” may turn out to be an institutional barrier to the healthy growth of P2P platforms). From the investors’ perspective, it is mostly about preventing fundraisers (borrowers) from making poor selections while screening investment options, so that relevant risks can be avoided ahead of time.

For this reason, P2P platforms are prohibited from offering guarantees, capital pooling, illegal fundraising or accepting deposits from the public. All of these are the thresholds for investor protection.

(3) Absent legislative debt recovery mechanisms

Since online lending has not been included in China’s General Rules on Loans, P2P investors would have serious difficulties recovering losses from fundraisers (borrowers) through legal means. Furthermore, due to the law of large numbers employed by P2P platforms in matching funding with financing projects, one single bad debt usually sparks off compensation claims involving dozens or even hundreds of creditors.

For this reason, P2P platforms have already started disclosing personal information of defaulting individuals as a compensatory control mechanism. However, it remains a key challenge as to how to form a bond between all affected creditors and seek debt recovery
from fundraisers through legal actions. Accordingly, reducing the cost of debt collection and creating an efficient collection mechanism in cyberspace have become burning issues for P2P companies during marketing and branding campaigns.

Transparency, flexibility, high efficiency, risk diversification, low barriers and cost-effective funding channels are the most salient features of P2P platforms, but all of them would be castles in the air without an effective legislative collection mechanism, big data and credit reporting and active control over fundraisers.

(4) Maturity mismatch remains a major risk

Thusfar, major P2P companies have already realized direct fund transfers between lender and borrowers’ accounts through technical innovation and collaboration with third-party payment processors. However, P2P platforms are unable to acquire mid/long-term investors for fundraising purposes, given their weak internal risk control capabilities, lack of market experience relative to banking financial institutions, uncertain regulatory policy, unfavorable macroeconomic conditions, lack of awareness among investors, and less competitive private funding costs.

The situation is further compounded by the fact that funds invested in Internet financial projects generally take longer to pay back and are mostly repaid in installments. This results in frequent changes in cash flow duration and, by extension, the risk of maturity mismatch in P2P platform transactions.