



Peer to Peer Lending

A Threat to Traditional Lending or Innovative Competition

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IN THIS ARTICLE WE TAKE A LOOK AT PEER TO PEER (“P2P”) LENDING, EXPLORING WHAT IT IS, ITS PROS AND CONS AND HOW IT IS REGULATED IN AUSTRALIA.

WHAT IS IT?

P2P lending has been heralded as the “Uber” of finance. In our app based world, convenience is key, and just as Uber matches people looking for a ride, P2P lending platforms match people who have money to invest with people who are looking for a loan.

The role of P2P platforms is threefold:

1. to provide a facility to enable investors and borrowers to come together outside traditional lending models;
2. to assess potential borrowers’ credit worthiness on behalf of investors; and
3. administer the loans.

Not all P2P platforms work the same way. Some platforms allow potential investors to pick their borrowers, where others are forced to lend across the P2P platform’s portfolio of borrowers. Some platforms have a protection fund, which borrowers are required to contribute to, and are designed to compensate lenders exposed to loans that have defaulted.

There is no doubt that P2P platforms are an exciting new financial product breeding healthy competition with the big banks. Some of Australia’s biggest names, including James Packer and Kerry Stokes, have backed one of Australia’s leading P2P startups, SocietyOne. Investors are keen to get on board and mimic the Lending Club, the first P2P platform in the United States (set up 8 years ago) which became the 14th largest “bank” in the US with a US\$9 billion valuation after its December 2014 initial public offering.

WHAT ARE THE BENEFITS FOR INVESTORS AND BORROWERS?

FOR INVESTORS

The benefits to investors involved in P2P lending include:

- the interest rates on investment are higher than if the funds were deposited in a bank;
- limited exposure to default as investors contribute small amounts across various loans to different borrowers; and
- P2P platforms disclose the lending risk at the time of the investment by assessing the borrower’s credit rating allowing investors to make informed decisions.

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FOR BORROWERS

The benefits to borrowers using P2P platforms include:

- lower interest rates compared to traditional banks; and
- simple procedure for smaller loan amounts (usually up to \$35,000).

Ultimately, both investors and borrowers benefit from the simple structure, as the P2P platforms themselves only make a profit from fixed arrangement fees, not from the interest charged to the borrower.

HOW ARE P2P PLATFORMS REGULATED IN AUSTRALIA?

P2P platforms are becoming more and more popular in Australia. The P2P platforms have taken various approaches to fitting within the existing regulatory regime, with most being structured so they fit within the framework of a managed investment scheme.

This is because a P2P platform is a facility through which a financial investment is made, therefore, it is required to hold an Australian Financial Services Licence. In addition, as P2P platforms offer credit, they also require an Australian Credit Licence and need to comply with AML/CTF requirements, as well as requirements under the *Privacy Act 1988* (Cth).

The view is that these regulatory requirements are quite onerous and costly. However, considering P2P platforms are hugely reliant on an assessment of borrower's credit rating, a benefit of complying with the managed investment scheme framework is that it ensures the P2P platform (and investors) thoroughly understand the credit rating of potential borrowers.

This view is supported by SocietyOne, who stated:

"We don't believe the current regulatory framework is a barrier to P2P models. On the contrary we believe that regulatory framework provides appropriate protection for consumers and guidance for P2P lenders."

However, there is concern that by "fitting in" to the existing managed investment scheme framework there is a risk that, at some point in future, ASIC will make a determination that such a model is not appropriate and either prohibit P2P lending altogether, (as it currently operates,) or make more onerous regulations.

It appears that ASIC's current position is that as P2P platforms have chosen to operate within the managed investment scheme framework, this ensuring they are regulated appropriately. Accordingly, ASIC has indicated that it has no plans to prescribe specific regulations. It is interesting to note, however, that in October 2014, New Zealand began issuing specific P2P lending services licences. It is considered that by regulating P2P lenders under their own category of licence, the New Zealand authority is well placed to rapidly respond to changes in P2P lending practices.

SO WHAT DO WE THINK?

It is fair to say that some P2P platforms in Australia will be pushing for a more bespoke regulatory regime in order to reduce the heavy compliance provisions that managed investment schemes are subject to, as well as achieve acknowledgment that P2P lending is recognised in Australia.

As Australia moves forward into this somewhat uncharted terrain, it will be interesting to see if, much like Uber, P2P lending receives its own legislative backing, or whether it will be forced to fit, somewhat clumsily, into the existing regulatory framework of financial products.

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