Analysis on the Risk and Supervision of P2P Online Financing Platforms in China

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Abstract

Microcredit is a vital breakthrough to solve the financial problems of low-income groups and small and medium-sized enterprises, while traditional microfinance providers can only meet a small proportion of their capital needs. By using internet technology, P2P online financing extends the innovative development of microcredit with the aim of solving traditional micro-credit problems. This paper mainly explores the existing online financing operation model of P2P in China, and summarizes the relevant problems, such as low entry barriers for P2P online financing enterprises and lack of supervision, lack of verification on the qualification of borrowers and poor management of the platform, imperfect information revealed or providing false information by platform, etc. Finally, the article put forward some suggestions concerning the healthy development for the P2P online financing platform, including the establishing entry audit system and strengthening the supervision of the P2P platform, strengthening the management of borrowers and improving the credit collection system, and strengthening the disclosure of information by platform.

Keywords: Microcredit, P2P online financing platform, Risk control, China.

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Publisher: Scientific Publishing Institute

Funding: This study received no specific financial support.
Competing Interests: The authors declare that they have no competing financial interests

1. Introduction

Microcredit (microcredit) refers to financial activities that provide financing services to micro and small enterprises, the poor or the poor families through informal channels, with the aim of expanding the range of choices of these groups and increase their productive investment, thereby increasing the income and employment opportunities for these groups. The amount of the loan is generally more than 1000 RMB, but less than 200,000 RMB.

Since 1993, China has witnessed some dramatic changes in microcredit financing for more than 10 years. The way of the funding has experienced the process from international donations, government subsidy to commercial operations. At present, China's micro-credit can be divided into three categories. First, the large banks may provide loans to the laid-off workers, full-time students, and poor families, with a total quota of hundreds of millions of RMB. Second, the rural credit cooperatives may provide small loans to farmers, where 61 million farmers have access to 192.7 billion of dollars in loans, covering 27.3% of all farmers. Also, there is also a portion of farmers ' loans, about 12 million households enjoying loans of 14.1 billion RMB. Third, the
presence of more than 100 non-governmental microfinance organizations provides loans of about 1 billion RMB.

From this, we can see that China is faced with a huge demand for funds. However, in the course of the operation of microcredit, many problems with national characteristics have arisen, resulting in problems in the supply of small funds, which not only deters some microfinancing institutions from lending but also makes some enterprises or individuals unable to borrow. Because of the lack of guarantee mechanism, excessive operating cost, and the lack of a good faith system, the development of microcredit is difficult. To a certain extent, internet-based P2P online financing model came into being, which solves part of the above problems. On the basis of reducing operating costs, internet-based P2P online financing increases the number of loans to individuals and enterprises.

P2P (‘peer-to-peer’ or ‘person-to-person’) online financing is a kind of business model which gathers a very small amount of funds and lend to those people with financing demand. The social value of P2P online financing is mainly embodied in three aspects, including meeting the individual financing demand, developing the personal credit system and improving the utilization rate of social idle funds. This kind of financial service based on internet technology is an innovative development of micro-credit, which uses the network platform to greatly broaden the scope for financing and spread the risk, and also solves the problems of traditional microcredit in the course of operation in another way (Banerjee and Vinayak, 2013).

2. The Operation Model of P2P Online Financing Platform

P2P online financing is a new way of realizing individual small loan transactions to individuals with the support of the network platform. The basic premise of its establishment is that individuals who need to borrow money can find individuals who have the ability to lend and are willing to lend on certain terms through online platforms, while online financing intermediaries help to determine lending terms and prepare the necessary legal texts.

The role of intermediary network platforms is to help spread risk by sharing a certain amount of money between different lenders while helping borrowers to choose favorable interest rate conditions in fully comparable information. Intermediary network platforms in return charge certain service fees. Through the P2P online financing platforms, borrowers and lenders establish a lending relationship between strangers. Borrower obtains funds with credit and commitment, while at the same time there is no need for collateral or guarantees. If a person lends an average of 100 RMB, 1000 people are 100,000 RMB. It is like water into a stream, these scattered funds across the country will form a huge pool of funds through the internet.

The specific operation model of the P2P Online financing platform is as follows. The borrower openly discloses the number of individual claims for capital financing, borrowing purposes, repayment period, credit history, bank cards, and income and expenditure details, rental contracts and other information to improve the audit pass rate, and then put forward the maximum interest rate that individuals can bear. The lender, by reading the information provided by the borrower, decides whether to lend or not and the interest rate (the central bank usually stipulate the rate should not be 4 times higher than the bank's benchmark interest rate) according to the individual's risk tolerance. In general, it is often the case that a borrower corresponds to multiple lenders so that the amount paid by each lender is not so much and thus reduce the risk for the lenders. Finally, the electronic ious are automatically generated and the borrower should only need to pay monthly repayment via online bank transfer.

P2P Online financing website generally charges about 1% to 4% of the service charge to the borrower and charges 1% or less to the lender. Overdue borrowers are charged with an additional penalty, which is shared by the collection agency and the P2P online financing platforms.

3. Analysis of the Problems Existing in the Online Financing Model of P2P: A Case Study of Wangyingtianxia

In 2006, China’s online financing began to develop, and by the beginning of 2013, Statistical data indicated that there were more than 1000 platforms in operation in P2P market. According to the estimation by Essence Securities, by the end of 2013, the P2P online financing platform transaction scale may reach 60 billion RMB, compared to 20 billion RMB in 2012. Under such a fierce momentum of development, we have to seriously consider the problem of what is hidden behind it?

However, the wave of P2P failures since October 2013 has sounded a wake-up call for industry and investors. In October 2013, 15 P2P Enterprises closed down, 20 P2P platforms were in the position of payment crisis. As in the November 2013, the tide of failure did not end, Tongdudai, Huiyin Investment Co., Jiajiaadi, Qiankundai, Baofeng VC, Pengchengdai, and some other P2P online financing platforms were also falling into the collapse of the storm with the difficulty of cash payment, investors suffered heavy losses. Almost every day a P2P financing platform goes bankrupt, so that a lot of P2P platform investors are terrified. Many people spread their money across different platforms, but in the end, the returns were zero. What caused this wave of failure? What is wrong with the P2P online financing model? Taking the online financing platform of the Wangyingtianxia as an example, this paper analyzes the problems with the P2P online financing platform.
3.1. Low Entry Barriers for P2P Online Financing Enterprises and Lack of Supervision

At present, China's P2P online financing enterprises only need to register in the Trade and Industry Bureau. Some P2P enterprises may register as "consulting" or "information technology" companies, which do not belong to the financial company. Such firms are not subject to the supervision of the CBRC and the People's Bank. This kind of P2P financing platforms, which crosses the boundaries between IT and financial industries, lead to increased difficulty of identifying them (Turvey and Kong, 2010). As a result, the results of "No supervision" were created, and each government agency regarded the P2P was not the scope of regulation of its own department. Such situations are related to the operation termination of Wangyingtianxia.

Wangyingtianxia online financing platform is operated by the Wangyingtianxia e-Commerce Co., Ltd in Shenzhen. It was founded on March 28, 2013. The company was registered with 20 million RMB by a quasi-listed enterprise. But when it went bankrupt, a lot of problems were found in the survey. First of all, the "quasi-listed" company-Huarun Tong Company mentioned by Wangyingtianxia in the company introduction has experienced the problem of integrity. Information from the P2P platform, Red Ridge venture capital, shows that Huarun has accumulated a total of 5 million loans through quick borrowing in December 2011 5-8th, with the borrowing rate of 24.18% and the term of 6 months. The title of the loan is "short-term capital turnover of the quasi-listed company."

"The company is now ready to go public, and now it needs to borrow some funds to clean up the loans from microfinance companies and guarantee companies that can be collected by the credit system to make the final impact on the listing," the loan note said. Even if the listing cannot be completed at the expected time, there is not much pressure on the 5 million repayments. But surprisingly, the "quasi-listed" company was overdue in its first month of repayment, and all borrowing was collected until the eighth month before it was fully repaid. Secondly, the Shenzhen Investment Guarantee Co., Ltd. as a subsidiary of the "quasi-listed" company mentioned by Wangyingtianxia did not appear in the repayment arrangements, indicating that the guarantee company did not really act as a guarantor, but as vaporware in the financing.

Wangyingtianxia provide no guarantor, publication of false information, no risk control and credit department, but only have more than 10 customer service, three or four technicians and a few financial personnel. How could it enter the P2P financing industry? In addition, how could the transaction amount have reached nearly 780 million RMB in a short period of 4 months? This question is very thoughtful. The lack of regulation and the lack of industry entry restrictions are some of the reasons for the formation of P2P online financing and platform failures.

3.2. Lack of Verification on the Qualification of Borrowers and Poor Management of the Platform

The examination and supervision of the borrower are insufficient, resulting in the inability of the lender to recover the funds. In addition, it does not have a corresponding punishment mechanism and guarantee mechanism (Chari et al., 2011). As long as the borrower does not repay the loan will not be returned. The main reason for the broken of the capital chain in the Wangyingtianxia is that the enterprises borrowing the loan cannot repay according to the promise. Wangyingtianxia once issued a lot of large amounts of financing bonds to absorb new funds, trying to pay back, but the hole in the end still failed to cover.

It is understood that by October 2013, just before the Wangyingtianxia go bankrupt, there are still nearly thousands of borrowers failed to recover the loan of about 200 million RMB. They did not fully examine the borrower's credit and repayment ability, and lend out only for the high profits.

The online information of Wangyingtianxia shows that on July 18, 2013, that is, after the expiration of the huge financing demand, the platform has issued a total amount of 12 million financing demand three times, with the aim of raising funds to deal with short-term liquidity difficulties. The borrowing period is 20 days, and the total interest rate is 3.25%-3.55%. In this way, borrowers are required to borrow at a higher interest rate than 3.25%-3.55%, and it is abnormal for monthly interest to be more than 3 points in general with offline financing. If borrowers are willing to bear this interest rate or even higher interest rate, indicating that borrowers are short of money and that repayment capacity is likely to be problematic, in which case there is a huge risk of financing control.

3.3. Asymmetric Information and Increased Risk of Investor

As an online financing platform, P2P should be more open and transparent than private lending. However, some P2P platforms refused to disclose the relevant information on the borrowers, with the nominal aim of protecting the borrower's privacy. Such transactions make the lenders bear more risks because of information asymmetry and the virtual nature of the network (Kuwabara et al., 2017). Many lenders choose the Wangyingtianxia only because of the high-interest rate. The majority of lenders in the Wangyingtianxia do not know the flow of their funds. After Wangyingtianxia goes bankrupt, there are lenders who say that the electronic contracts do not have any binding effect. After Wangyingtianxia bankruptcy, there are still many borrowers who do not know the flow of their funds. After Wangyingtianxia goes bankrupt, there are still many borrowers who do not know the flow of their funds. After Wangyingtianxia goes bankrupt, there are still many borrowers who do not know the flow of their funds. After Wangyingtianxia goes bankrupt, there are still many borrowers who do not know the flow of their funds.
the huge amount was created by only 34 users named "wytx_+ letter" format of the account, and the average cumulative borrowing reached 23 million per account. The flow of funds is unclear, and the borrower's information is unknown, which giving the platform the opportunity to operate in the dark, while at the same time increases the risk of borrowers.

4. Implications for Risk Control on P2P Online Financing Platforms: The Experience of Prosper in the U.S.

4.1. Establishing Entry Audit System and Strengthening the Supervision of the P2P Platform

In terms of regulation, the United States is the strictest. Since 2008, after the Securities and Exchange Commission investigated and rectified its domestic P2P enterprises, the United States has requested P2P's products to be registered as securities and to comply with the Securities Act of 1933. P2P microcredit companies were required to list its products in detail in its regularly updated business report. Moreover, the Securities and Exchange Commission requires that P2P companies' reports be open to the public through the "Electronic data-collection, analysis and retrieval" System.

After the rectification of the United States, the operation model of P2P enterprise, Prosper and Lending Club, was securitized. Borrowers and lenders on the platform of Prosper and Lending Club reach an agreement of lending-borrowing relationship through the purchase of the corresponding notes, which lenders pay to certify the purchase of bonds issued by borrowers. Such bonds are usually traded for premium or discount on the third-party trading market.

All in all, after the rectification, Prosper and Lending Club have lost the characteristics of the typical P2P online financing model, and move towards the direction of securitization, whose regulation in the future may also be included in the SFC supervision. The United States is at the forefront of the world in the regulation of P2P enterprises, which is also the general trend of all P2P online financing enterprises.

China should clearly position the identity of P2P online financing enterprises, and make clear the corresponding regulatory agency. Because of the complexity and cross-regional nature of the business model of P2P online financing platform, the supervision mechanism should be developed from single-channel supervision to multiple-channel supervisions. In particular, the People's Bank and the CBRC can be responsible for formulating relevant regulatory policies, and local governments should give full play to the functions of financial supervision. While at the same time, the State Administration for Market Regulation, Ministry of Industry and Information Technology, and the Public Security departments should work together to standardize the operation of the P2P online financing platforms. The State Administration for Market Regulation may supervise the registration, issue the business license of the P2P online financing enterprises, and monitor whether the P2P enterprise carries on the operation supervision according to the approved business scope or not. If the P2P enterprises want to operate an online trading platform, they need to be filed in the Ministry of Industry and Information Technology, which may regulate the online transactions of P2P. If the P2P online financing platforms have illegal fund-raising activities and other criminal cases, the Public Security Department has the right to intervene in accordance with the law.

4.2. Strengthening the Management of Borrowers and Improving the Credit Collection System

In foreign countries, the relatively perfect credit system has been formed, everyone's credit history is well documented. In the United States, for example, Americans have a lifetime Social Security number, which is linked to an individual's credit score, and P2P online finance companies only need to work with professional rating agencies to get these scores, thereby reducing information asymmetries and reducing credit risk. The Prosper's review of borrowers is strict, leaving its overall bad debt rate at less than 2%. Specifically, after the borrowers have been registered, Prosper will conduct a preliminary review of its registration information and give an initial rating. After the borrower has applied for review and rating, Prosper will also conduct a post-audit review, that is, whether the documents provided by the borrower are complete and the authenticity of their documents. Even if the late audit is passed, Prosper will not immediately lend the borrower, but will further review the authenticity and complete nature of the documents provided by the borrower for an audit period of 2-8 working days, within which the borrower must provide all the real documents required by Prosper. Otherwise Prosper could cancel its loan.

China should also establish the corresponding audit institutions for P2P enterprises, specifically for the borrower audit service. At the same time, banks, governments and other departments should also give some support to P2P online financing enterprises with the provision of the borrower's credit history. In addition, according to the characteristics of China P2P online financing model, a number of P2P online financing platform should jointly create a "P2P Online Financing Credit System", which provide a network system to the borrower’s loans, repayment records and other related users of his (her) evaluation registered on the joint platform.

4.3. Strengthening the Platform Information Disclosure System

Prosper in the United States makes its website relatively more transparent because of its list of borrowing requests. After the company has conducted a preliminary review, its borrowers are required to post a list of
borrowing requests on the website, including the type of loan, the amount of the loan, the duration, the interest rate, the monthly repayment, the borrower’s prosper rating, the progress of the loan, and the number of days remaining to be raised. Because the borrowers will be audited 2 times at a later stage, there will be a certification progress chart on the borrower’s loan application list, divided into 1st, 2nd, and 3rd stages, and the lender can judge the loan risk based on the progress on the loan list.

China’s P2P online financing enterprises should also publish a similar list of borrowing requests on their websites so that lenders can clearly understand the specific situation of borrowers. At the same time, P2P enterprises should also clearly and truthfully publish the borrower information with bad records on its website, further reducing the risk to lenders.

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