

The Need for Facilitating Electronic Payments in the Peer To Peer Lending Sector

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The peer to peer (“**P2P**”) lending sector, which currently remains largely unregulated, has undergone substantial growth and has eased the process of financing by facilitating borrowers and lenders (primarily individuals) to connect with each other conveniently on virtual platforms (“**P2P Platforms**”).

P2P Platforms offer an avenue for financing which is distinct from conventional methods like bank financing, by doing away with snags such as complicated application and appraisal processes. However, this sector is presently hampered due to certain legal stipulations that restrict the transfer of the funds relating to the P2P lending transactions through electronic modes, which increases the logistical costs involved and renders the P2P lending process inefficient and inconvenient.

This article seeks to make an argument for facilitating the electronic payments in the P2P lending sector through regulation and suggests an approach in this regard.

How P2P Lending Generally Works

P2P Platforms do not lend any money directly, but merely connect the lenders and the borrowers and facilitate the P2P lending transactions *inter se* between such lenders and borrowers, through the virtual platforms. Further, P2P Platforms also conduct due diligence/background checks of the lenders and borrowers, the details of which are provided to the lenders and the borrowers for assisting them in the process of selection of their respective borrowers and lenders.

The documentation for the lending transaction is executed between the concerned lender and the borrower which also stipulates the interest rate at which the loan is being granted (which is generally determined by the concerned lender), and pursuant thereto the loan amounts are transferred directly from the lender to the borrower and repaid by the borrower to the lender. Further, the P2P Platform charges certain fees from either the lenders or the borrowers or from both for providing its services.

Legal Hurdle

The main legal hurdle restricting electronic payments in the P2P lending sector relates to the various money lending acts enacted by various States in India. P2P lending transactions, if construed to be “money lending” under the Money Lending Acts, will require compliance with the terms of the Money Lending Acts by the P2P lenders, including registration of the lenders who are granting “loans” as defined under such Money Lending Acts. Therefore, it is imperative to determine if such P2P lending transactions constitute the activity of “money lending”.

Many Money Lending Acts have defined a “loan” to exclude an advance made on the basis of a negotiable instrument as defined under the Negotiable Instruments Act, 1881, other than a promissory note. It is to be noted that there are Money Lending Acts of some States in India which do not provide the aforesaid exclusion. Most P2P Platforms are ensuring that the loan amounts are transferred by the P2P lenders through cheques and repayment occurs through post-dated cheques (which are ‘negotiable instruments’ as defined under the NI Act) issued by the borrowers, thereby ensuring that such P2P transactions do not constitute “money lending” under the relevant Money Lending Acts.

The Reserve Bank of India has acknowledged the growing importance of P2P Platforms and is formulating regulations for the P2P lending sector. The RBI has also issued a consultation paper in April, 2016 wherein it had expressed its intention to regulate the P2P lending sector, *inter alia*, by regulating P2P Platforms as non-banking finance companies (“**NBFCs**”), and had also sought views and opinions from the public on the same.

However, the aforesaid consultation paper has not appropriately delved into the issue of payments relating to P2P lending transactions being made by electronic modes. Further, it is to be noted that laws relating to “money lending” can only be enacted by States in India and hence the RBI would have to take into account such Money Lending Acts if it intends to issue Regulations which facilitate payments through electronic modes in the P2P lending sector.

Suggested Approach

In order to facilitate the use of electronic modes of payment in P2P lending transactions, the following structure may be considered for the purpose of the Regulations to ensure such transactions are not in violation of the Money Lending Acts.

Further, the below mentioned structure would retain the essence of the underlying business model i.e. the P2P Platforms being the facilitators of P2P lending.

a) The P2P lenders would transfer monies that they intend to loan to borrowers firstly to the P2P Platforms (“**Investment Amounts**”) as investments into the P2P Platforms (“**Investments**”), and the Investment Amounts would be utilized by the P2P Platforms to grant loans to borrowers. The amounts received by the P2P Platforms from the borrowers (towards repayment of the loans granted) would be transferred to the lenders as repayment for the Investments. This structure would in effect render the P2P Platforms as ‘lenders’ to the borrowers. The reason we are suggesting this structure is because, if the P2P Platforms are regarded as ‘lenders’ (and since they are to be classified as NBFCs as stated above), then the Money Lending Acts would not be applicable *ab initio* in respect of the P2P lenders and hence would facilitate the use of electronic modes of payment in the P2P Lending Transactions.

b) Further, to avoid risk of mismanagement/diversion of the amounts payable to/receivable by the lenders and the borrowers as part of the P2P lending transactions (“**P2P Amounts**”), it can be stipulated that the P2P Amounts would be routed through a specific bank account (“**Account**”) in the name of the P2P Platforms. The permissible credits and debits relating to this Account can also be specified in the Regulations. It may be noted that, in such a case, P2P Platforms will obtain their fees for services provided by them in relation to the P2P lending transactions directly from the lenders and the borrowers;

c) Additionally, in this structure, the P2P Platforms’ role is to be limited to aggregating the transactions between lenders and borrowers, conducting KYC checks on the borrowers and the lenders, facilitating the execution of the transaction documents for the P2P lending transactions and transferring the monies received in the Account *inter se* between the lenders and borrowers. The P2P Platforms would also assist in the recovery of dues from the borrowers, but the responsibility in this regard (and the risks relating to default by borrowers) would lie with the lenders. It may be contemplated in this regard that the loans in respect of which there has been default by the borrowers will be assigned to the lenders upon such default, which also needs to be permitted by the Regulations; and

d) In terms of documentation for this structure, there can be two options that can be considered:

i) the P2P Platforms would execute investment agreements with each of the lenders in terms of which the lenders would make the Investments, and the P2P Platforms would execute loan agreements with each of borrowers in

terms of which the P2P Platforms grant loans to the borrowers using the Investment Amounts; OR

ii) the P2P Platforms would execute tripartite agreements with the lenders and the borrowers, in terms of which the lenders would make the Investments and the P2P Platforms would grant loans (using the Investment Amounts) to the borrowers.

Conclusion

While presently there are legal dilemmas surrounding electronic payments for P2P lending transactions, steps taken by the RBI to facilitate electronic payments for such transactions (which could include taking into consideration the suggested approach as stated above) would be an invaluable step towards the growth and sustainability of the rather nascent Indian P2P lending industry.

Such steps would definitely help foster the P2P lending sector, by making the lending process more efficient and convenient, thereby providing access to funds to individuals who otherwise would not have access to finance from conventional lenders and help the Government and the RBI's financial inclusion agenda.



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