

P2P Lending Platform Risk Assessment, Mitigation, and Control

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Abstract

P2P has grown quickly over the past ten years as a kind of direct lending between individuals in the financial sector. But as China's economy has grown, many issues with P2P network loan lending have steadily surfaced. Strengthening risk management is at the heart of P2P for sustainable development. This paper, which is based on an analysis of the idea, model, and positive significance of peer-to-peer network credit, primarily discusses the policy and legal risks, regulatory risks, and money laundering risks that P2P network credit faces and suggests solutions, such as creating a credit system, improving a credit management system, improving internal control, strengthening supervision, and industry self-regulation. These offer some fresh concepts for P2P lending platform risk management. In addition, this paper offers a critical evaluation and outlook on how the P2P sector will develop in the future.

Keywords

P2P Risk; Online Lending Platform; Market Supervision; Credit System.

1. Introduction

Peer-to-Peer and loans are direct lending operations between people without the need for financial intermediaries like banks, and they are facilitated by internet platforms that offer credit intermediation services [1]. P2P is a form of online financing that works well in addition to traditional finance. Due to its contractual character, convenience, speed, and the efficacy of the financial services licensing regulation, it is increasingly favored by small and medium-sized investors and borrowers. A P2P corporation is typically used as a platform for free bidding between debtors and creditors, which leads to the establishment of a debtor-creditor relationship. The borrower repays the principal on time, the lender receives interest and assumes the risk, and the P2P organization is paid for providing the intermediate service. P2P operating models in China can be broadly categorized as wholly online models and offline-restricted versions [2]. To assure the success rate of collection, P2P uses both pre-loan control and post-loan supervision. Moreover, the P2P lending platform will verify the information of all borrowers, and in addition to the authentication of identity information, work status, income, and personal credit report, it should also conduct video, interview, and field surveys in order to judge and verify the identity of borrowers as well as the true status of collateral in all respects. Additionally, it is vital to rigorously evaluate the legitimacy of the borrower's borrowing purposes and to eliminate the practice of borrowing for false reasons. For business borrowing, this necessitates that the borrower produces the pertinent justifications and documentation to support the borrowing, such as the purchase contract, store lease contract, and business license. The home mortgage platform will analyze the legitimacy of the lender's property, if it is secured, whether it is seized, the house's market value, and its condition [3]. The benefits of the P2P lending platform are undeniable. P2P has the qualities of fewer loans and ease of use, which partially fills the void left by traditional finance. While collaborating with conventional finance,

demonstrates the inclusiveness of financial services, continuously stimulates product innovation, and fulfills the diverse demands of clients more effectively. Second, P2P can foster the growth of private capital and improve its service to the actual economy. Simultaneously, it can significantly cut the transaction costs of financial institutions, enhance the efficiency of capital allocation, and improve the quality of financial services. However, P2P is also a double-edged sword, and its development is limited by the various threats it confronts.

2. The Main Risks Faced by P2P Platforms

2.1. Legal and Policy Risks

Currently, there are rules and regulations in China that specifically address "Internet lending," such as the *General Principles of Civil Law* and the *Contract Law*, but there are still no laws and regulations that address P2P lending platforms [4]. The primary danger for P2P lending platforms is that they are not required to pay the lender anything in the event of a default by the borrower. Loans are graded according to the risk and return, ranging from low risk/low return to high risk/high return, however, the grading system lacks transparency. The models and algorithms employed by lending platforms to classify borrowers according to their creditworthiness based on credit risk are ineffective. This has raised questions about the rating and credit quality of this unsecured lending sector. The absence of pertinent laws is one of the causes of the runaway events of online lending platforms.

Additionally, P2P network lending services lack a clear market access method. The number of problematic P2P online lending platforms in 2018 was over 4,800, there were over 1.32 million investors, and the total amount of loans involved was over 96 billion yuan, according to statistics tracked by the China Electronic Commerce Research Center [5]. Indicating that the absence of a market access mechanism has decreased the general quality of Internet financial platforms, the number of P2P problem platforms expanded rapidly between 2013 and 2018, and the amounts involved were different.

2.2. Regulatory Risk

Since China does not provide a specific legal definition for P2P lending platforms, the industry has very low access channels and loan information is unknown. In terms of social science, education, and humanities research, legal regulation has not advanced adequately. The State Council gave the CBRC control over P2P platforms in 2014, however, the rule is insufficient. Platforms can use a variety of strategies to get around regulations. They will run bigger financial risks while avoiding regulation. The security of borrowers' and lenders' information, including their identities and financial information, is compromised when technical flaws in the platforms are present. The lack of complete statistics may lessen the impact of the policies implemented by the CBRC and other pertinent departments. Additionally, due to a lack of adequate regulation, P2P network lending is subject to a variety of self-contained business models [6]. Figure 3 illustrates the diverse characteristics of the causes of P2P problem platforms between 2018 and 2019. As a result, if there is no regulatory body to constrain it and steer it in a better direction, such P2P network lending will be challenging to develop for a long time.

2.3. Risk of Money Laundering

The Chinese regulatory framework expressly prohibits P2P platforms from establishing capital pools. To accomplish platform transaction settlement and fund custody, most platforms will establish intermediate accounts with third-party payment platforms or banks. Generally speaking, the intermediate accounts are supervised by third-party institutions. Due to the frequent flow of funds, a small number of funds, and heavy responsibilities, however, many institutions fail to fulfill their operational and regulatory obligations. Moreover, liquidity is essential for the normal business operations of any P2P platform. However, the liquidity risk

will increase because there will be a disparity in the number of funds between borrowers and lenders and because the platform cannot create a pool of funds to absorb deposits.

As the P2P network lending platform has low threshold sex, wrongdoers can easily lend their illegally acquired properties to borrowers in installments through the platform, resulting in a reduction in the size of the funds. Then, through the platform's funds recovery system, their illegal funds become legal. The relevant laws and regulations of China's anti-money laundering law do not currently include Internet-based financial transactions. Therefore, if immediate measures are not taken to control it, the P2P lending platform is likely to become a haven for money laundering by criminals exploiting legal loopholes [7].

3. Risk Management and Control Measures for P2P Platforms

As a business model in which borrowers directly establish debt obligations, the core of peer-to-peer (P2P) business is its ability to price risk. P2P companies can only avoid unnecessary losses during the development of P2P by managing and controlling the various risks associated with P2P. This can effectively protect the rights of lenders and boost the confidence of banks, allowing P2P institutions to profit by avoiding credit risks as opposed to maliciously increasing lending rates. It should establish a sound regulatory mechanism for P2P, clarify the regulatory identity, and carry out all regulatory responsibilities for the P2P credit business. With "clear positioning," "not touching money," "threshold," "focus on transparency," and "strengthen self-regulation" as guiding principles, self-regulation will be strengthened. It should control the operating model, business areas, risk and interest rate management, and clarify each party's responsibilities. In addition, peer-to-peer platforms are prohibited from providing security services, self-financing, establishing capital pools, and enhancing the oversight of third parties in relation to funds. Then, it can develop specific platform user information security, promptly remove unqualified platforms, and ensure the orderly conduct of business. Furthermore, it can establish a credit rating index system based on qualitative and quantitative analysis, develop a unified credit assessment standard, and promote a more stringent credit rating index system.

The primary focus of the initial phase is qualitative analysis. After the sample data has been collected, the focus will gradually shift to quantitative analysis, and big data technology will be used to strengthen the credit system and develop a data risk control model through data mining. It is also applied to the decision engine and evaluation card system to enhance the automation of decision making, reduce the high cost of manual auditing, and resolve the issues resulting from inconsistent manual auditing standards. Consequently, the creditworthiness of borrowers can be rated based on loan information, allowing borrowers to better comprehend loan risks and reduce credit risks.

4. Conclusion and Future Direction

In China, the pure platform model of P2P platforms is more compatible with the online lending industry's growth trend. In contrast to traditional financial institutions, the P2P industry has a high degree of freedom, and its goal is to create an open platform that enables lenders and borrowers to conduct free transactions. If platforms are involved in transactions, the online lending industry will tend to become a conventional financial institution. In addition, if transactions are involved, P2P platforms will be subject to stricter risk management requirements, which will make it more difficult for the industry to develop. Currently, 68 percent of P2P operating platforms allow capital pooling and misappropriation of bank funds, and 23 percent of platforms have an annual yield greater than 11 percent. This increases both the cost of loans to borrowers and the likelihood of default. If these platforms are not effectively modified, they will be eliminated in the massive industry reorganization. According to the adage "survival of the fittest," while many problematic P2P platforms are collapsing, there are many

good platforms that are working diligently to secure assets and do an excellent job of risk management. These platforms are legitimate and compliant, and they do not rely on astronomically high returns to attract investors. In China's current environment, the combined online and offline model and third-party guarantees provide some protection for early-stage platforms and investors. The model enables better control of platform and lender risk, but severely restricts the P2P industry's scope, akin to traditional microfinance.

However, the online-only model has greater growth potential. With the improvement of China's credit system, the gradual reduction of platform operation risks, and the elimination of transaction volume bottlenecks, the region-free online model will grow in importance. Although there are still numerous issues in China's P2P industry, such as illegal fundraising, lack of guarantee for platform funds, borrower credit rating, and transparency of platform information disclosure, regulators continue to promote the industry's growth and innovation. In short, with the improvement of laws and regulations and the credit system, numerous unauthorized P2P platforms will be eliminated to preserve the platform with a scientific development model, a perfect management system, and risk management precautions, and to continue exploring the development of the P2P industry with more flexible use of funds.

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