# Trends Observed in the Chinese Peer-to-Peer Lending Market and Expected Changes on the Enactment of Regulations

by

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**Introduction**

Traditional financial market in China was composed of four main categories: banking industry, securities industry, insurance industry and trust industry. Before the popularization of Internet since 1995 in China and the consequential rise of internet finance, financial activities in China were majorly controlled by the four traditional financial industries, and speaking of loaning activities, bank was the one and only authority that provides the service. However, although the banks had the entire market, they did not satisfy every demand from the market. In fact, the banks only picked out the 20% important and key clients, usually large or state-owned enterprises (SOEs), who were able to create 80% of all profits created; and the rest 80%, which were mainly individuals and small and medium enterprises (SMEs), were left unattended ("Pareto's Law"[i]). As China's economy started fast growth, the power of every individual of the huge population was revealed. Many economists in China believe if the financing problem of the crowd is not solved, it would become an inevitable burden for financial industries' future long-term growth.

Instead of the Pareto's Law followed by traditional financial institutions, Internet finance businesses act according to the long-tail theory, which states that even though the financial demands of individuals and small businesses are fragmented and not of significant profitability, as long as the population of the individuals and small businesses is large enough, the altogether demand will then become too grand to be overlooked. Consequently, Internet finance businesses successfully complement for what large traditional financial institutions are incapable of, and grow swiftly due to the large population base of China.

Peer-to-peer (P2P) lending businesses were one of the internet finance businesses that joined Chinese market when the economy was going up and when Internet was gradually becoming popular in China. Peer-to-peer lending is a lending activity among individuals, later extends to businesses (P2B), through online intermediaries. From P2P lending, borrowers expect convenient capital raising and lenders expect financial returns in the form of interest payments and a repayment of capital over time. The primitive aim of P2P lending platforms was to connect strange individuals in order to satisfy their loaning and investment demands which were previously ignored by the banks. The first P2P lending platform landed in Chinese market in 2007. Although the business idea was not popular until 2011, it grew wild after that. As P2P lending businesses got popular, services and products involved evolved. Till 2014, P2P lending platforms in China have evolved into three major business models: like credit card model, like collateral bond model and like asset securitization model[ii]; moreover, asset types expanded. The entire market has gone through a dramatically growing period at the rate of 2 to 3 new P2P lending platforms getting online per day from 2011 to 2014.

Along with the high growth, problems occur. Unsecured loans on P2P lending platforms led to high risks followed by countless bad loans and various credit problems. Some founders of P2P platforms even start their business with ill intention of fraud. What’s worse, the market of such a messy situation had remained unregulated for a very long time, and the reputation of P2P lending market as well as platforms became notorious. Eventually, by the very end of 2015, CBRC, together with Ministry of Industry and Information Technology (MIIT), Ministry of Public Security (MPS), and Cyberspace

Administration of China (CAC), put forward <<Interim Procedures on Business Activity Management of Peer-to-peer Lending Information Intermediary Institutions>> (<<Interim Procedures>>).

The purpose of this research is to comb and summarize some outstanding changes in P2P lending market as it developed on its own prior to year 2016[1], in order to find out the reasons behind the changes and to predict future trends after the enactment of regulations.

**Expansion of asset types in P2P**

Before year 2013, that is, before the great leap on the number of platforms from 110 to more than 600, P2P lending means micro-finance credit loans between individuals. As more business get involved in this market, P2P lending gradually developed beyond its original concept of micro-finance and more asset types are involved. In year 2014, various asset types are divided into six major groups: micro-finance, guaranteed loans, building property and auto mortgage, corporate lending supply-chain lending and others[iii]. In year 2015, the market further developed under each category of asset types and the business can be defined by three broader division of asset types: mainstream assets, vertical assets, and emerging assets[iv]. The trend is clear; as the market develops, the asset types involved gets more sophisticated. The push behind the variation of assets is important to inquire into and see how and where it may lead the entire P2P lending market to.

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[1] Most discussions in this research will be focused on from year 2013 to year 2015. Because most dramatic changes and growth took place during that period of time and more data and researches are available on that period.

The only and original asset type that peer-to-peer lending businesses did at the very beginning was micro-finance credit loans. Credit loans between individuals was the field traditional financial institutions in China failed to attend to and thus, the incentive of P2P lending business was to fill the gap and meet the enormous unsatisfied demand of the mass. The banks did not attend to the individuals' credit loans for a good reason: the credit environment was poor in China. The individual credit reporting system in China was not established until 2004, and by year 2014, less than four hundred million individuals, that is, a quarter of the total population of China, had credit record in the system[v]. Thus, the risk of credit loans to individuals was high and the the efforts to lower such risk would be difficult and costly. Consequently, the first four years of P2P lending business, from 2009 to 2012, did not went on very well. On the one hand, many responsible P2P lending platforms endeavoring to lower credit risk through offline investigation struggled on the huge amount of human cost and low efficiency; on the other hand, problematic platforms either failed in risk control and ended up in bankruptcy or they themselves become a risk of the business as more and more of them disappear with the investors' money. Apart from the backwardness of the credit environment in China and the consequent high risks both for the platform operators and the investors, the P2P lending business model remained a hit in the market. The number of new entries increases by large amount starting from year 2012 and the market boomed from 2013 (Figure 1). As the size of the market grew larger and more people got involved, investors' aware of risk rises and micro-finance credit loans are not sufficient to satisfy more risk-averse investors' needs. By year 2014, less than 40% of the platforms had businesses in micro-finance credit loans, and the transaction scale only counts for 5% out of the entire

P2P lending market transactions; by year 2015, the percentage dropped to around 23%, with less than 50 platforms' main business in micro-finance[vi].


| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|---|
| Newly Established | 2 | 1 | 7 | 16 | 34 | 101 | 531 | 1537 | 1624 |
| Accumulated Operating | 2 | 3 | 10 | 25 | 52 | 142 | 573 | 1701 | 1748 |
| Accumulated Total | 2 | 3 | 10 | 26 | 60 | 161 | 692 | 2229 | 3853 |

Figure 1. Number of Platforms from Year 2007 to 2015

Around year 2012, guaranteed loan as an asset type was introduced to P2P lending market as a way of risk control. Guarantors of guaranteed loans are not limited, they can be qualified individuals, factoring companies, asset management companies or financing guarantee companies and usually, the guarantors are the providers of the asset to the platforms. In contrast to micro-finance credit loans, guaranteed loans enable to attract larger amount as well as longer maturity loans from investors. Although it turns out that from time to time, the guarantors are actually not capable of paying back when defaults occur, guaranteed loans are still a much powerful means than credit loans in attracting the investors and in lowering default risks to some extent.

Residential and auto mortgage loans are new asset products to P2P lending market; they did not become popular until 2014. Like guaranteed loans but better in risk control, residential mortgage and auto mortgage loans are attractive to investors of risk-averse appetite. As shown in Figure 2 and Figure 3, from 2014 to 2015, residential mortgage P2P lending did not increase sharply in the number of platforms involved but the transaction scale tripled throughout a year; auto loans P2P lending increase significantly both in the number of platforms involved and in the transaction scale. Due to the different valuations and characteristics of residential buildings and automobiles, the mortgage loan assets generate loans of 1.5 million RMB on average and the maturity varies from several months to 2 years, while auto loan assets generate loans of ten thousand on average and the maturity is usually within six months[vii].

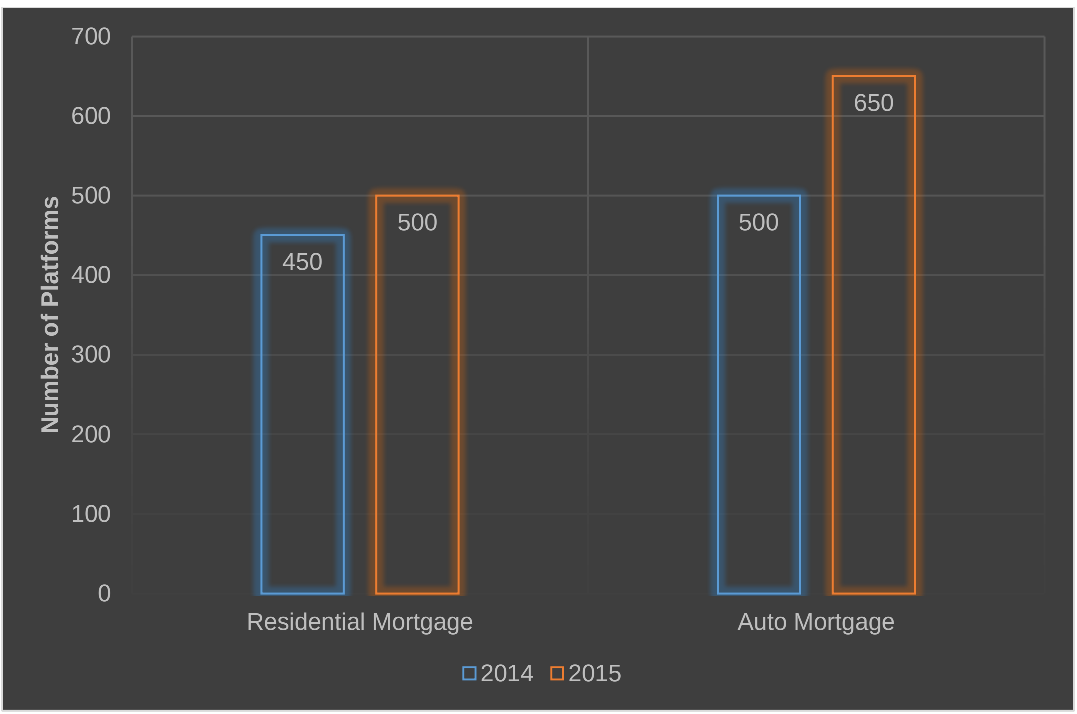


Figure 2. Number of Platforms with Business in Residential and Auto Mortgage in 2014 and 2015

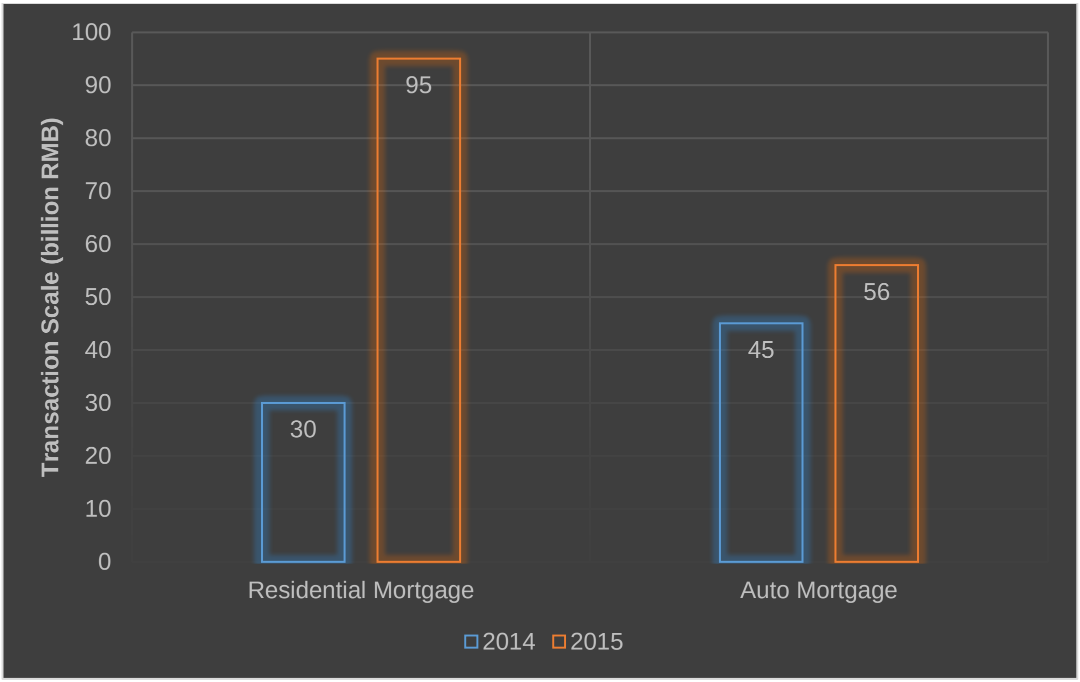


Figure 3. Transaction Scale of Residential and Auto Mortgage in 2014 and 2015

Micro-finance credit loans, guaranteed loans, building property, auto and other mortgage loans together form the mainstream asset category in P2P lending business; these assets altogether generate 700 ~ 800 billion RMB transaction scale, while micro-finance credit loans accounts for less than one tenth of it[viii]. In other words, P2P lending market in China, is gradually shifting its business focus from fields that banks do not serve to wider range of areas that banks do serve but poorly. This shift of targets suddenly opens up the market of P2P lending service.

Consumer finance, or to be more specific, university student consumer credit services, is one of the latest targets P2P lending services aim at. In 2009, China Banking Regulatory Commission (CBRC) forbad offering credit card services for juveniles under age 18, as well as those over age 18 but have no stable income sources[ix]; thus, most banks completely froze credit card services for university students. In the same year, CBRC put forward consumer finance pilot projects to stimulate demands and promote consumption[x]. The two forces together push the university students away from traditional financial institutions for credit services yet towards Internet finance. Starting from year 2012, with the continuous growth of university student population, university student credit services develop into a huge market of more than 400 trillion RMB by year 2015 with estimated 5% annual growth rate in the following four years[xi]. P2P lending platforms introduce installment loans as an asset type in 2014. In 2014, nine platforms had their main businesses on installment loans and the total transaction scale was five hundred million; in 2015, the numbers grew to 50 platforms and 25 trillion RMB, and most of them do university student credit services loans.

P2P lending business evolved beyond peer-to-peer lending and reached out for peer-to-business(P2B) lending. For example, in year 2012, Ministry of Commerce of PRC set out commercial factoring pilot project[xii]. Beforehand, factoring was a proprietary business controlled solely by banks; and banks favor large and medium-size enterprises, as a result, factoring of small and micro businesses remained unattended. The pilot commercial factoring business, thus, takes care of the unattended enterprises and one way they themselves get financed is through P2P lending platforms. The same business idea applies for trade acceptance collateral loans and some other supply-chain financial products. Even though in 2015, supply-chain financial products generated only thirty billion RMB transaction scale out of nearly one trillion total transaction scale in P2P lending market[xiii], it is estimated that the market size of supply-chain finance is around eight trillion RMB by the end of 2015 and the number will reach 15 trillion RMB by year

2020[xiv]. Therefore, supply-chain financial assets entering P2P lending market would be a win-win for both promising markets.

Besides the products mentioned above, there are more. Many products are minor components of the market for the time being but they may catch up very quickly as long as the environment allows. For instance, banks in China are trying to get rid of their non-performing assets (NPA) and P2P lending market turns out to be a good choice for them. Products such as stock financing and down-payment loans are testing the water.

In general, the expansion of asset types in P2P lending market enables it to cover more fields of the market, which also indicate the potential of P2P lending industry in the vast Chinese market. In 2014, when the expansion of asset types started to boom, it happens on every platform, that is, each platform mix operate services on different assets, from micro-finance to mortgage loans, and from peer-to-peer to peer-to-business. The platforms see the ability to provide various services as the capability of gaining customers of various investment appetites and thus the ability of surviving the fierce competition in the market. Nevertheless, after one years' struggle, the phenomenon of mix-operation faded. The platforms found it difficult to be specialists on all the services they provide, and it was costly and risky. As a result, in year 2015, newly established platforms chose to be more focused on a certain vertical asset, such as university student consumer credit loans, and dug deeper into the specific market. Therefore, different platforms had their own business concentration and stopped groping about aimlessly.

**Increase of Market Concentration Rate**

Although the number of new entries into P2P lending market kept increasing, the old and new platforms no longer develop evenly across the market. Over years of development, platforms set up for more than three years has accumulated plenty of resources of assets, as well as has established reputation among the customers; these elements directly affect survival, so it is harder and harder for new-entries to find footholds in this market. That is to say, despite the increasing number of platforms, instead of growing in a radial pattern, P2P lending market is in fact gradually converging to higher ranking and comparatively established platforms.

The traditional and the oldest service, micro-finance credit loan service, show the converging pattern obviously. By 2015, around 400 platforms out of 1748 normally operating platforms have micro-finance credit loan service; while seven high ranking platforms out of the 400 accounts for 80% of the transaction scale of micro-finance credit loan service[xv]. This trend is not as strong as in micro-finance credit loan service as in building property mortgage loan service, because the service itself is novel to the market, thus it creates chances for new platforms to win some space in the new service field; however, the trend of concentration does become visible even within only two years of development of mortgage loan service. By the end of 2015, approximately 500 platforms provide residential mortgage loan service, among which the top 12 platforms accounts for 40% of the total transaction volume of this service[xvi]. In other words, even for the very new service in P2P lending market, the first 2% platforms create 40% transaction volume of the entire corresponding market.

Figure 4 is the P2P lending market concentration rate in December, 2015. The chart illustrates that the top 10 platforms create 25% of the entire market volume, i.e., the first 0.6% of the platforms create more than a quarter of the entire market volume. And the top 80 platforms accounts for more than half of the entire market transaction volume, which means that the rest 1668 (95.4%) normally operating platforms are struggling for the rest 50% market.

| **Market Concentration Rate Index** | **$CR_5$** | **$CR_{10}$** | **$CR_{20}$** | **$CR_{40}$** | **$CR_{60}$** | **$CR_{80}$** | **$CR_{100}$** |
|---|---|---|---|---|---|---|---|
| **Percentage %** | 18.55 | 25.15 | 34.28 | 42.75 | 47.23 | 50.06 | 51.85 |

Figure 4. Market Concentration Rate[xvii]

**Formation of the "Ecosystem"**

As P2P lending market grow in a fast pace, accompanying services and institutions catch up in recent years. On the asset end, as P2P platforms develop more products of different asset types, distinct institutions are involved in P2P lending business. For example, factoring companies provide guaranteed loans, and banks provide NPAs. On the fund end, apart from the majority individual investors, institutional investors, such as asset management companies, as well as online marketing servers which help to advertise products and attract investors, are playing vital roles. In between both ends, demands for intermediary services like third-party payment services and law services call for the participation of corresponding companies. Due to years of high bad loan rates, continuous vicious incidents, and thus bad reputation, what the investors care the most, which is also what the platforms are striving to improve, is the credibility of each platform and the entire P2P lending market.

Generally speaking, credibility can be improved from within and by outside force. From within, platforms are seeking further cooperation with traditional financial institutions. In July 2015, <<Guideline on Promoting Healthy Development of Internet Finance>> (Guideline) is published; Guideline encourages insurance companies to cooperate with Internet Finance businesses to enhance their ability of resisting risks. Insurance companies mainly provide performance bond insurance and credit bond insurance services for creditors[xviii], i.e., investors on P2P lending platforms. Besides gaining direct insurance services from insurance companies, some platforms develop mortgage loan products based on guarantee policy with insurance companies as a way of increase product credibility. P2P lending platforms are also cooperating with regional financial asset exchanges. Regional financial asset exchanges are usually controlled by local governments or SOEs, and the information disclosure by the exchanges provide information transparency that many platforms lack.

The earliest self-regulatory organizations (SROs) that establish a convention for P2P lending in China is China Association of Microfinance (CAM). CAM first established the convention in 2012 and made revision in 2014. According to the newly revised convention, CAM defines P2P lending platforms as information intermediary and it requires that member platforms should apply real-name registration on both investors and borrowers, the fund from the investors should go to certain third-party such as banks or third-party payment companies that could separate the money from the platform in case of vicious intention of fraud; it forbids platforms self-finance. CAM also requires regular audit and timely information disclosure[xix]. Besides CAM, there are about thirteen SROs around the nation by the end of 2015, either regional or national associations[xx]. Since the specific data is not available, here I assume that each platform joins only one SRO just to get a broad picture, then there would be about 500 platforms joining in SROs by the end of 2015. Compare to the total of almost 4000 platforms, 500 is not a persuasive enough number to demonstrate credibility of the market, but 500 does mean the changing altitude and better awareness of the platforms.

To sum up, even if there were no formal regulations before 2016, P2P lending environment is gradually growing into a more comprehensive and inclusive market. The market is like a robot with more and increasingly refined parts and components, it strives to become better-functioned.

**Increasing Ratio of Problematic Platforms**

The most concerning problem in Chinese P2P lending market is the number of problematic platforms. Figure 5 implies that as the total number of platforms increase year by year, the number of problematic platform is rising even quicker. The wild growth is understandable before 2015 since the market was novel and immature, it takes time for the participants to explore and try the market; however, the fact that the wild growth kept swiping the market all the way to year 2015 makes the situation abnormal, because by 2015, the market has expanded largely into various asset types and the ecosystem has taken shape; it was time to slow down. The failure of slowing down in time resulted in the dramatic rise of problematic platform ratio in 2015. Figure 5 clearly shows that the problematic platform ratio rises from less than 20% in year 2014 to nearly 40% in 2015, which almost doubles.

For most problematic platforms, two major reasons can explain their problems: first, the market is not unlimited; after five years of wild growth, fewer and fewer empty markets are available to explore for an increasing number of platforms. Crowded competitors makes life hard for each other, especially the new entries, and they become problematic unwillingly. Second, observing the messy status described above, some join the market to intentionally be problematic platforms in order to cheat money out of the uninformed investors.

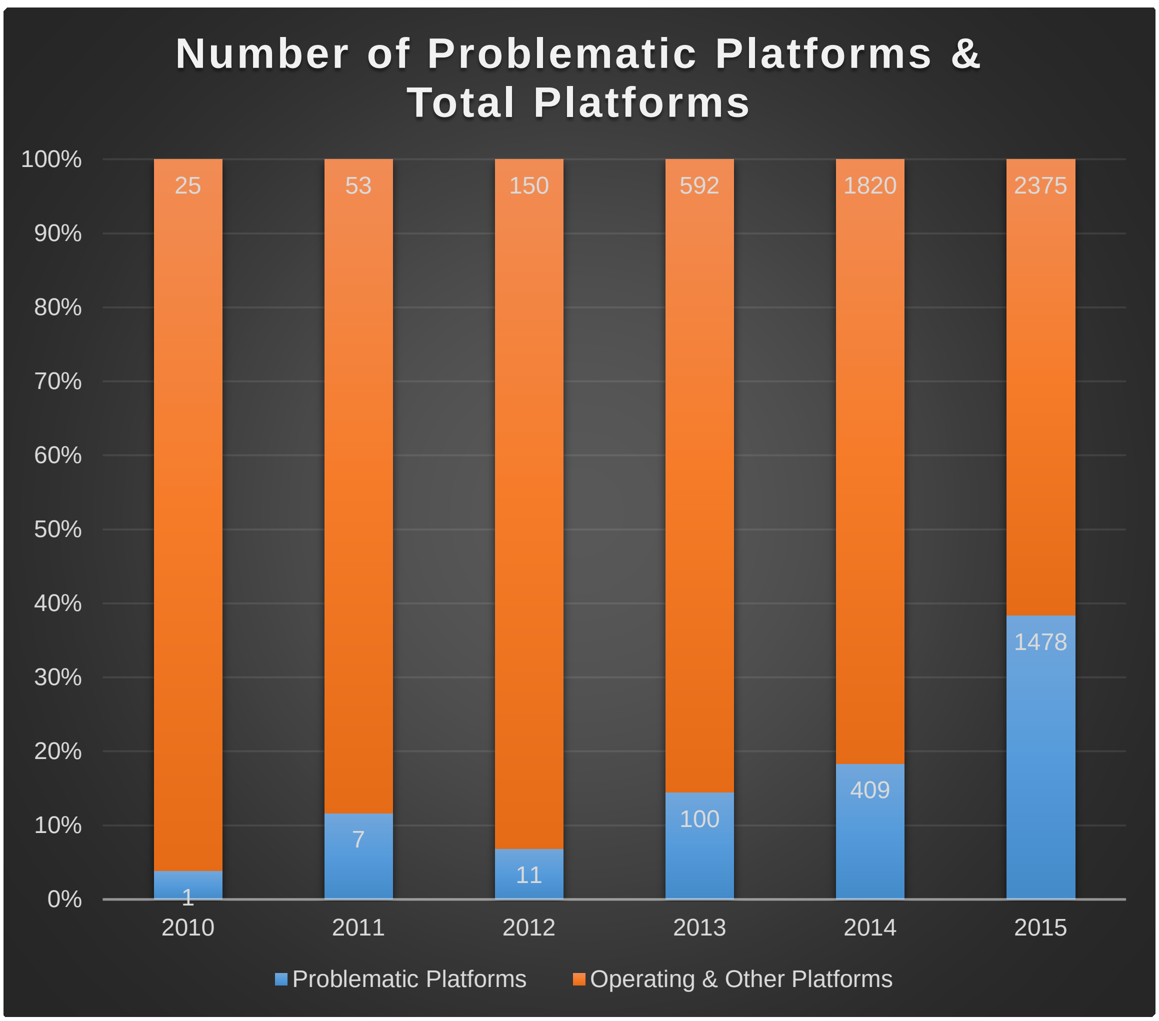


Figure 5. Number of Problematic Platforms & Total Platforms[xxi]

There are many types of problematic platforms. Categorizing them by the two reasons they became problematic I mentioned in the previous paragraph, losing contact, malicious escape and fraud fall into the second reason, that is, intentionally problematic; and the rest are the ones that became problematic unwillingly due to incapability of operation. Calculation shows that the intentionally problematic ones account for 75.24% of all the problematic platforms in 2015. One notorious case under this category worth mentioning is the “eZu Bao” incident broke out in December, 2015. eZu Bao went online in July, 2014, during the one and a half years, it managed to illegally fund-raise more than 70 billion RMB transaction funds, and nine hundred thousand investors were involved[xxii]. Ponzi scheme was the trick. eZu Bao created fake financing projects, lured investors with high returns and used a small part of the collected fund on paying back the principal and promised interest to create the illusion that the platform was running well. Due to the huge amount of funds and large population of investors involved, this vicious incident had terrible consequence on the P2P lending market. It crushed the faith of investors in this market heavily and many struggling platforms faced deposit runoff following the incident and eventually announced bankruptcy. Most intentionally problematic platforms use similar tricks as eZu Bao, they first find some ways to cheat the money out of investors’ pocket, then they themselves have control on that money, and they either keep the platform running using Ponzi scheme for a period or they disappear immediately.

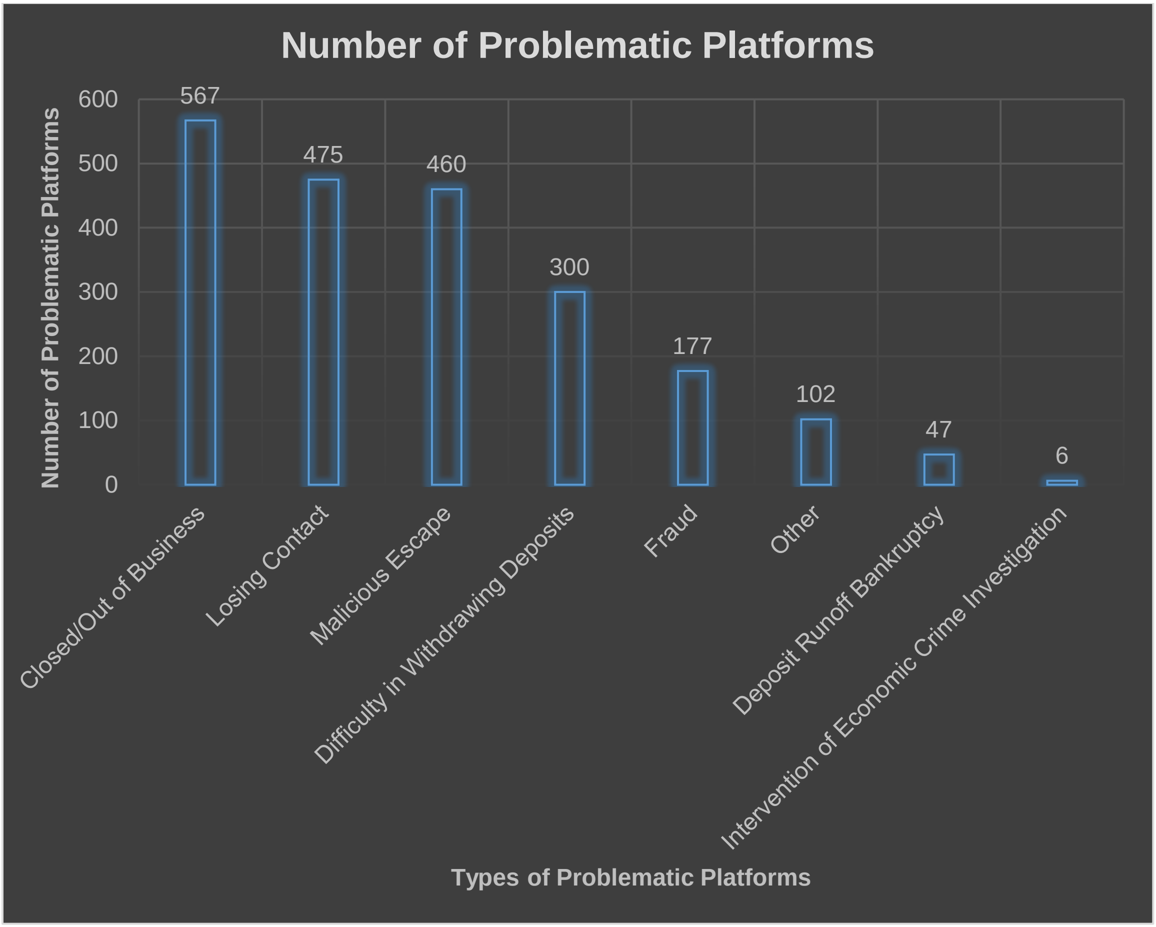


Figure 6. Types of Problematic Platforms in 2015[xxiii]

One outstanding common point among problematic platforms is that most of them are young platforms. The pie chart below shows that at least 69.6% of the problematic platforms had operated for less than one and a half years, i.e. at or less than the age of eZu Bao. The pattern can be explained by the rise of concentration rate. As the market converges to the top platforms, little chances are left for new players. Half of the market is already in the hand of the top 80 platforms, so on average, every platform other than the top 80 shares 0.03% of the market. In face of very limited profitable space and fierce competition, the platforms try their best to win more customers, for example, by lending to someone who had already borrowed money from other platforms for the same reason.

In short period of time, the platforms obtain more customers, but in the long run, these type of borrowers accumulate credit risk till one day when these borrowers fail to pay back one by one. Plus, the platforms need to deal with aftermath of continuous vicious incidents such as the eZu Bao one. Therefore, survival without any issue is extremely challenging.

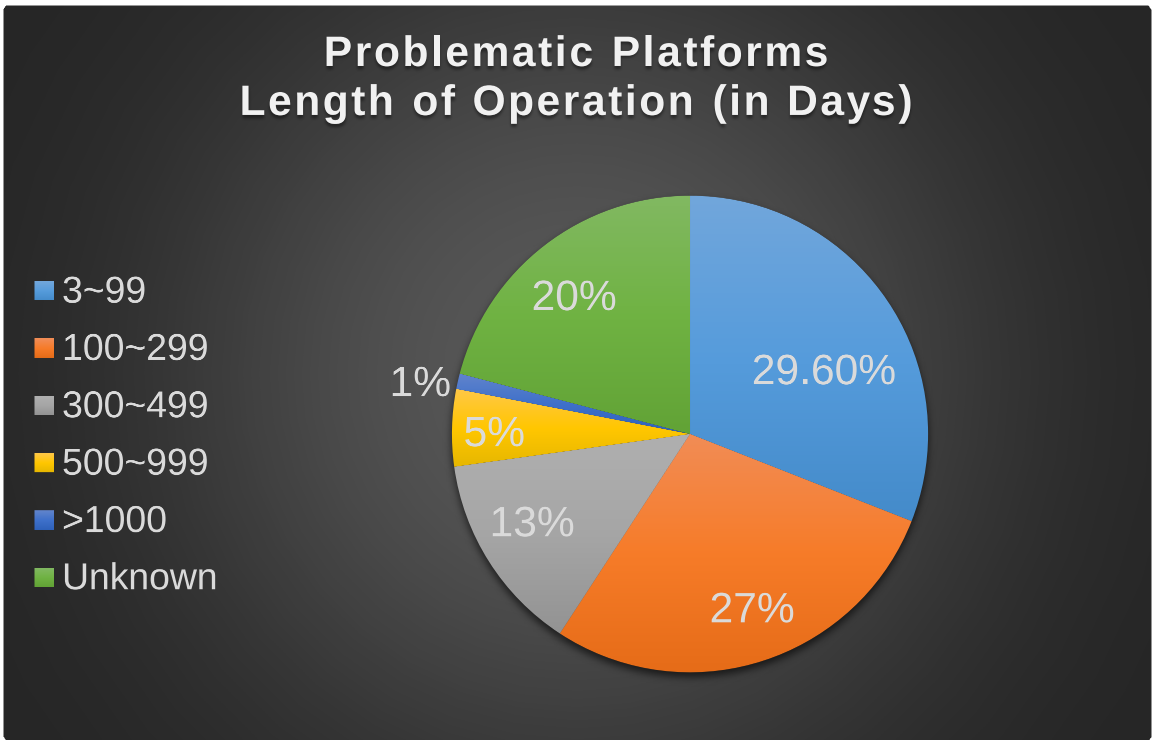


Figure 7. Length of Operation of Problematic Platforms[xxiv]

**Chinese <<Interim Procedures>> and UK's <<Regulatory Approach>>**

Researchers, participants and investors has been expecting some regulations on P2P lending market since 2012, there had been rumors on the release of regulations over the years. Eventually, <<Interim Procedures on Business Activity Management of Peer-to-peer Lending Information Intermediary Institutions>> came out in December 2015, about three weeks after the broke out of eZu Bao vicious incident. Early in 2014, UK Financial Conduct Authority (FCA) has released <<The FCA's regulatory approach to

crowdfunding over the internet, and the promotion of non-readily realisable securities by other media>> (<<Regulatory Approach>>), which is also the first regulation regarding P2P lending in the world. <<Regulatory Approach>> successfully guide UK P2P lending market onto a healthy track of development, and meanwhile, UK regulators manage to remain the market an innovative and dynamic place. As a consequence, I would like to examine and compare <<Interim Procedures>> and <<Regulatory Approach>> in this section.

For UK P2P lending market, FCA has set a £20,000 fixed minimum requirement as one of the quantitative threshold of entrance, and the amount was raised to £50,000 after 1 April 2017. Surprisingly, <<Interim Procedures>> set no quantitative requirement at all as the threshold of entrance for the platforms. Another worth-noting distinction between the regulations of the two countries is the way they treat the client money. The client money can either be investors' investment before being distributed to various borrowers or it can be interest and capital repayments of borrowers before being returned to the investors. In <<Regulatory Approach>>, UK platforms have the right to hold the client money as long as their treatment is subject to the client money rules by Client Asset sourcebook (CASS). However, the situation is very different in China. As discussed in "Problematic Platforms" section, many of the intentionally problematic platforms committed Ponzi scheme and disappear with the client money, therefore, Chinese regulators deem it very important to separate the client money from the platforms in order to control the risk. Consequently, third-party capital supervision institutions are mandatory in <<Interim Procedures>>; banks are the only choice currently, but in the future, third-party payment companies may also become an option as in some SROs' did in their conventions. The blank requirement on capital and the compulsory capital supervision well explain how the regulators position P2P lending platforms in the whole P2P lending business: information intermediary institutions. Information intermediary means basically means that the platforms are merely a marketplace for information exchanges. This definition is the very primitive idea of what P2P lending platforms do, but in reality in Chinese P2P lending market, most platforms provide services far beyond that definition. Because of the backward credit reference system, transactions among strangers lacks credit, therefore, many platforms promise to undertake default risks in case of bad loans in order to attract more investors and later, some started to offer trust enhancing services[2]. These two measures seem beneficial to the investors but they in fact bring negative effects because most platforms do not have the capability to take the risk of defaults. Therefore, the promises made by the platforms in fact misguide the investors into unwise investment decisions.

So as to prevent the fake promises misguiding the investors, <<Interim Procedures>> bans the platforms from undertaking default risks and offering trust enhancing services themselves completely. In addition to the two bans, there are eleven more. The bans are all on the activities and products of P2P lending platforms, which, for example, includes forbidding offline sales in order to have full supervision of all business activities through online measures and forbidding financing projects' maturity resolution, selling self-developed financial products for self-financing, selling banks' financial products, funds, insurance, security-based assets, or trust products on a commission basis, doing like asset

[2] The trust enhancing services here refer to the services provided by the platforms themselves to the investors for the borrowers. This is a completely different concept with the cooperation between the platforms and insurance companies in order to improve platform credibility, the latter of which is encouraged by the government.

securitization businesses and financing for high risk derivatives and etc. The thirteen bans are called “negative list management[xxv]”, which is a nationwide market access system applicable to all industries, fields and business activities issued by State Council of China in October 2015. The aim of negative list management is to draw clear boundaries for government supervision while leaving out more autonomy for the market itself to compete and innovate[xxvi]. The thirteen bans explicit state the baseline of P2P lending activities and above the baseline, regulators are expecting further development and innovation of this business.

In comparison, UK regulators do not set any restrictions on specific business activities and products in <<Regulatory Approach>>. Other requirements such as annual audit and report, disclosure of annual report for customers, real-name registration of borrowers, lenders and third-party capital supervision accounts and quantitative limitations on borrowing amounts are some common rules in <<Interim Procedures>> and <<Regulatory Approach>>.

**UK P2P Lending Market**

The very first peer-to-peer lending platform, Zopa, originated in U.K. in 2005. The business was popular but its real development did not come until the 2008 global financial crisis. The crisis restrained banks’ ability to provide loans and the lowering of interesting to zero or even negative during quantitative easing process repressed investment demands. Consequently, individuals and small and medium enterprises (SMEs) looked for other vehicles to lend and borrow at an affordable interest rate as well as an attractive return rate.

In 2014, the U.K. government put forward regulation of crowdfunding platforms and peer-to-peer lending is under the category of loan-based crowdfunding. The purpose of the regulation is to provide “adequate consumer protections that do not create too many barriers to entry or significant regulatory burdens for firms”[xxvii]. Briefly speaking, the regulation on loan-based crowd-funding is composed of capital requirements, client money protection rules, dispute resolution rules, exit rules and conducts[xxviii]. As expressed in the very beginning of the context of the regulation document, the U.K. Government priorities are “achieving more diverse and accessible financing for individuals and SMEs as well as more rigorous competition in retail banking services”[xxix]. In this sense, the 2014 regulations are to guide and gently control the development of peer-to-peer market development instead of harsh restriction. The development of peer-to-peer market may become more promising starting from 6 April 2016 since the U.K. Government allows investments in Individual Savings Accounts (ISAs), plus, it also allows for pension money being invested in peer-to-peer loans[xxx]. In general, the U.K. Government is creating a lightly-regulated yet highly free and innovative environment for the potential growth of peer-to-peer lending market.

The most prominent development of the peer-to-peer lending market are the increase of transaction volumes. As is show in Figure 8, from 2014 to 2015, all models of online alternative finance experienced notable growth in market volume, with peer-to-peer lending (including peer-to-peer consumer lending, peer-to-peer business lending and peer-to-peer lending in Real Estate) outperformed all of the other models. In terms of growth rate, peer-to-peer business lending, including in real estate, experienced a 99%

growth from 2014 to 2015 and an average growth rate of 194% from 2013-2015; peer-to-peer consumer lending experienced a 66% growth from 2014 to 2015 and an average growth rate of 78% from 2013 to 2015[xxxi]. These growth rates show a trend of the deceleration of the increase of market volume after the regulation came into force since 2014, but still, the annual growth rate is undoubtedly high. One phenomenon worth noting is the rise of peer-to-peer lending in real estate within short period of time. The market volume of peer-to-peer lending in real estate mounted to £609 million in 2015, accounting for around 41% of the entire peer-to-peer business lending in 2015.

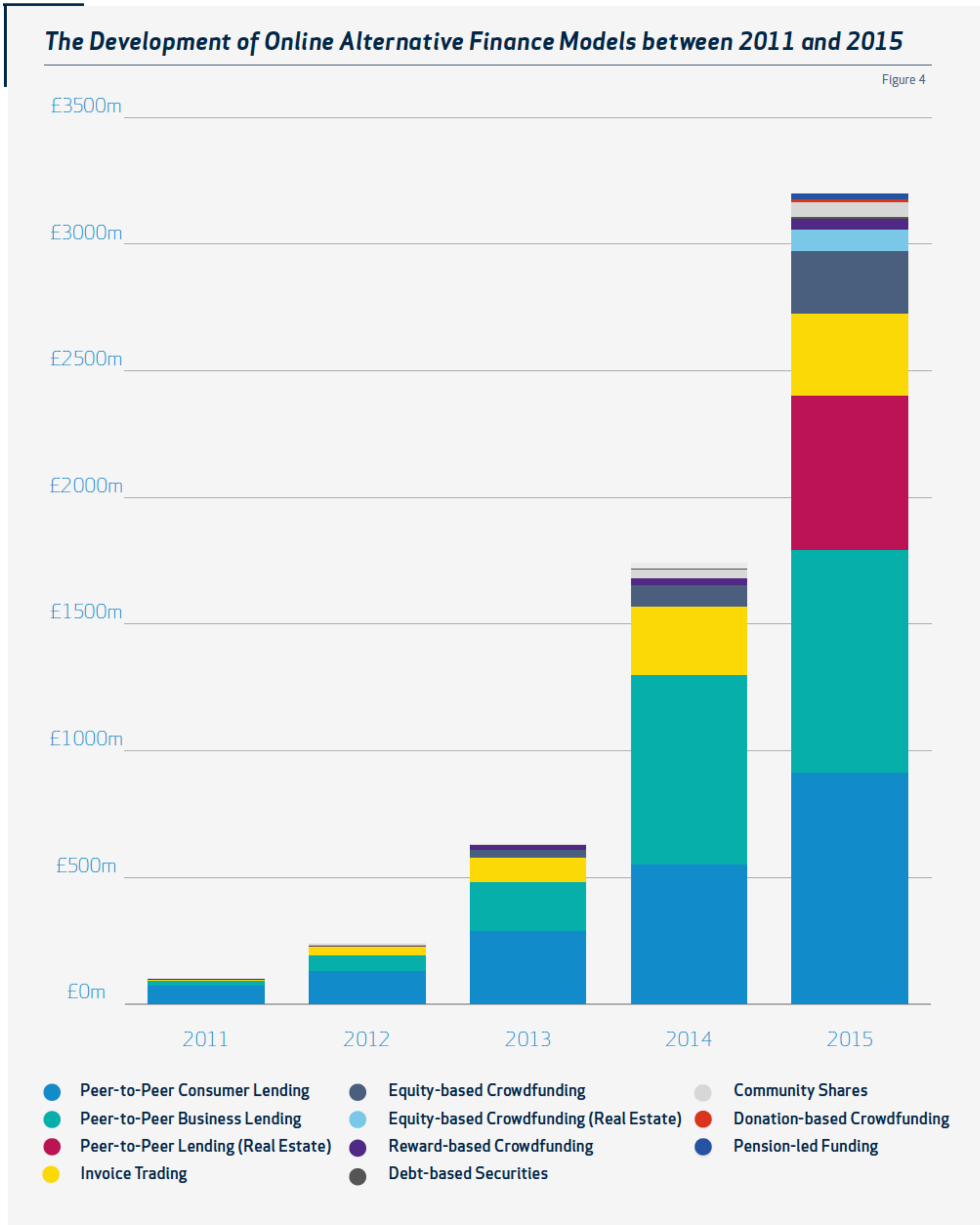


Figure 8[xxxii]

Another widely observed change in the peer-to-peer lending market is its investor base. According to the U.K.'s Financial Conduct Authority (FCA) report, in 2015, "26% of business loans and 32% of consumer loans were funded by institutions[xxxiii]". As Figure 9 shows, the percentage of institutional funding across all peer-to-peer models are increasing quarter by quarter in 2015, and increasing trend is expected to continue. FCA shows concerns on whether the institutional investors are treated by the platforms with favorable terms, which may transfer higher risks onto retail investors. For the time being, however, the entry of institutional investors brings mostly positive impacts on the development of peer-to-peer lending market. The institutional investors are banks, and investment funds. On the one hand, funds such as pension fund tend to invest for longer terms on the platforms, which helps sustain the stability of the market; on the other hand, the increase of institutional investors help guide the market to become more professional; moreover, the entry of institutional investors give retail investors confidence on their investment and help the platforms build up their credibility and public awareness[xxxiv]. The occurrence of swiftly increasing peer-to-peer lending in real estate can be explained by the increase in institutional investors.

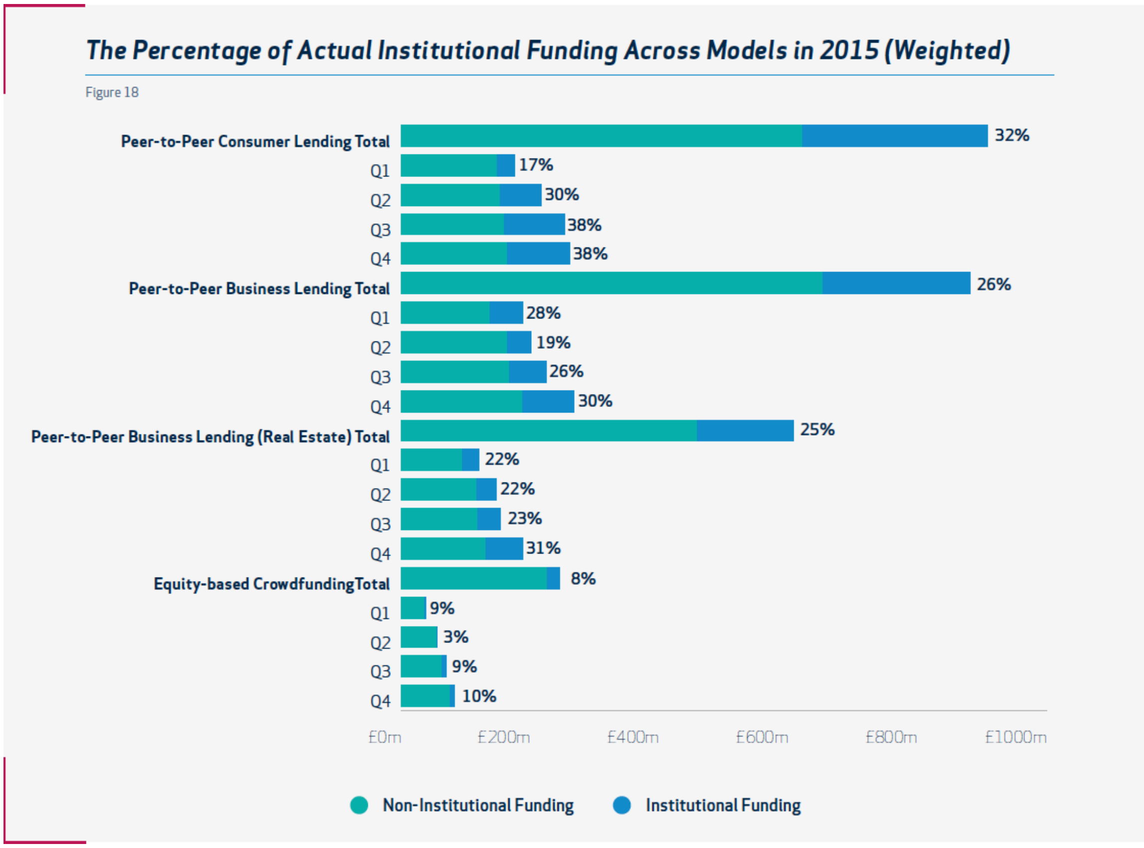


Figure 9[xxxv]

Even though peer-to-peer lending is still a new and prominent market with high growth rate and increasing investors, its market entrants start to go down and some says "market is beginning to consolidate"[xxxvi]. Figure 10 illustrate the trend of new entries over the past ten years in the general alternative finance platforms; although the graph does not specify the condition in peer-to-peer lending market, peer-to-peer lending has always been a major part of alternative finance platform in the U.K. So what can be implied from Figure 10 is that the U.K. peer-to-peer market has gone through the period of wild development from 2011 to 2013, and with the timely publish regulations on the market in 2014, the U.K. peer-to-peer market is transforming into a rationally expanding, lightly regulated, healthier and more mature market. According to FCA's 2016 review, there are only 9 firms fully authorized as loan-based crowdfunding platforms, 88 firms with interim permissions or licensed prior to 2014, and dozens still seeking authorization[xxxvii]. Combining the decelerated of the number of new entrants and the also decelerated but still high growth rate observed from 2014 to 2015, it is fair to conclude that the regulation came into force in 2014 has successfully guided peer-to-peer market into an orderly development and in the meanwhile promotes the potential for innovation and steady growth.

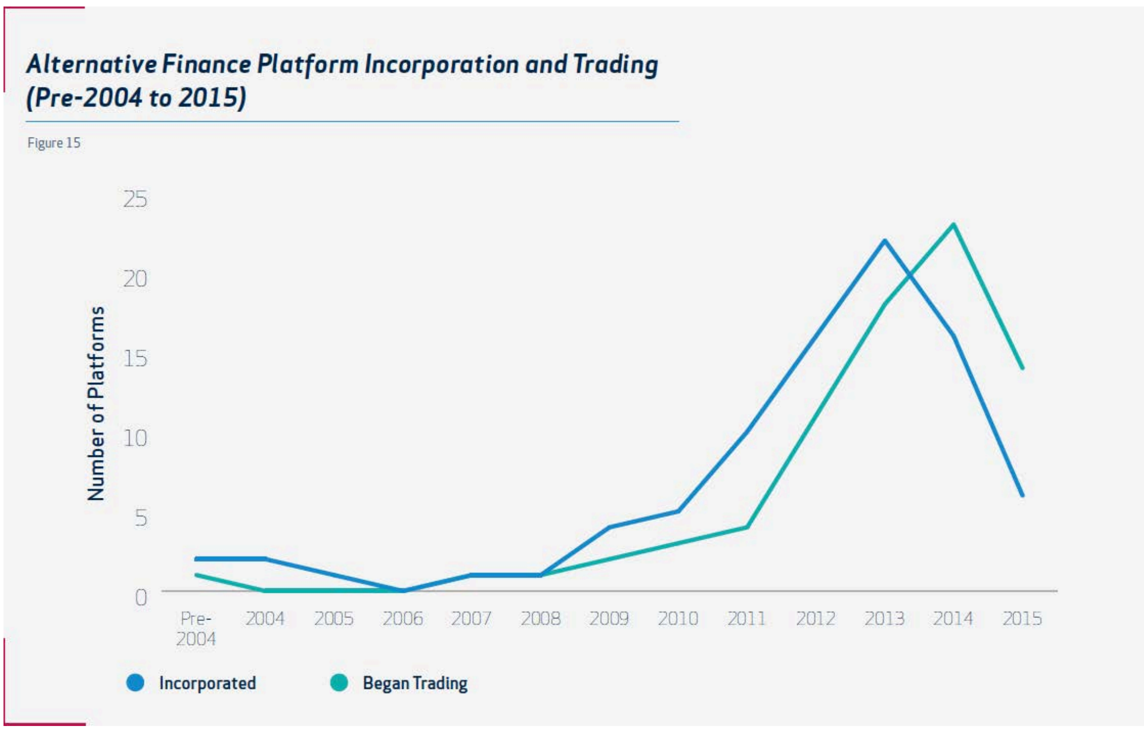


Figure 10[xxxviii]

## Changes to be expected in Chinese market

In terms of number of platforms and new entries of P2P lending platforms, some tendencies are very clear from figure 11[3] after the enactment of the regulations. The

[3] The data I use in Figure 11 and Figure 12 are collected from data provided on www.wdaj.com, which is an online community that provides data, news, ratings and other information on peer-to-peer lending platforms and industry. This source of data provides distinct data on the platform number from what *China P2P Lending Service Industry*

accumulated total number of platforms is approaching but not exceeding 6,000 by the first quarter of 2017. The accumulated growth rate has experience continuous drop since April, 2015 and the number of new entries also started to decrease since the third quarter of 2015. <<Guideline>> published in July, 2015 emphasized the necessity of sound regulatory regime in building a healthy internet finance market order. What follows tightly are rumors on the contents of the regulation, such as predictions on specific capital requirement on the platforms like fixed minimum capital requirement for entering the market or risk reserve capital in case of bad loans, in order to limit wild growth and prevent risky events in accord with the requirement of <<Guideline>>. Thus, on the issurance of <<Guideline>> at the middle of 2015, the market expected strictness on entering P2P lending market, which led to a decrease on number of entries since the third quarter of 2015.  Even though eventually <<Interim Procedures>>does not set specific requirement on capitals,  the thirteen bans on P2P lending activites and products as well as the mandatory third-party capital supervision act as invisible thresholds for the platforms that want to profit from high risk products and that want to play with client money. The decrease of growth in number of platforms stared in mid-2015 and the trend continued till the end of the first quarter of 2017, i.e., when the collection of data of this paper was ended; and notice that the accumulated growth rate is near 0% in the first quarter of 2017. This uninteruptted trend of decrease means that the decrease started from mid-2015 is not only an instant market reaction on <<Guideline>> or <<Interim Procedures>> but also an honest reflection of the market condition at that time: although the number of total platforms and new entries are high, the real growth is not. Beneath such high numbers are high chances of vicious incidents such as the eZu Bao one and

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*Development Report* collected due to different criteria the two sources applied when collecting data. However, the general trends both sets of data show are assumed to be similar.

high problemtic platforms ratio. It is time for the market to cool down and be guided to a normal and healthier growth. <<Interim Procedures>> provides a twelve-month rectification period and it is obvious from figure 11 that one year from the issuance of <<Interim Procedure>>, the number of players in P2P lending market is well controlled to a maximum value.

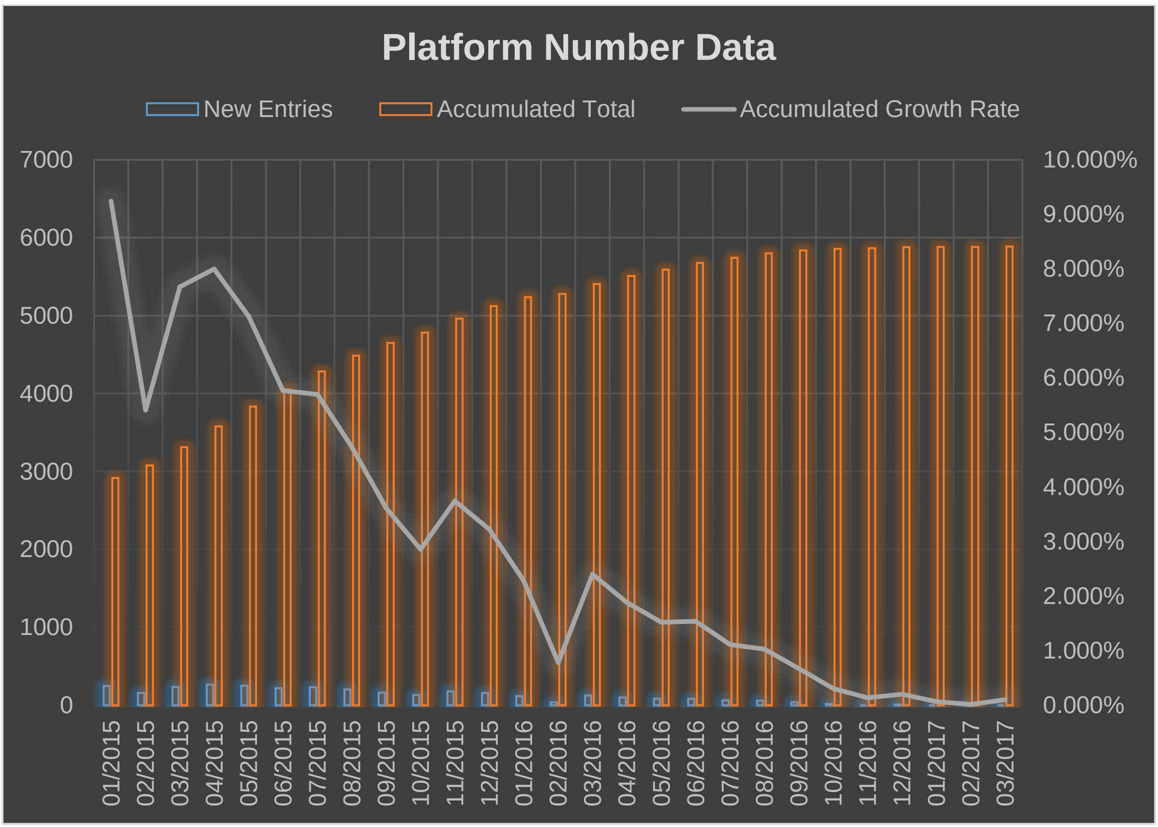


Figure 11. Platform Number Data[xxxix]

In addition to the changes on number of total platforms and new entries, types of problematic platforms have altered greatly as well. In figure 12, “Out of Business” platforms are the ones that chose to quit P2P lending market actively without legal concerns, the ones that chose to transit to other businesses such as wealth management companies, and the ones that are temporarily shut down for rectification. “Malicious

Escape" platforms contain the ones that are under "Losing Contact", "Fraud", and "Malicious Escape", i.e., the intentionally problematic ones as I categorize them in previous analysis. In 2015, "Malicious Escape" was the major cause of problematic platforms, and "Out of Business" followed. In 2016, after <<Interim Procedures>> came into force, the portion of "Out of Business" platforms increased dramatically and ranked the first out of the four causes and "Malicious Escape" became the second most cost. This trend indicates that on the enactment of <<Interim Procedures>>, more platforms chose to quit automatically. The thirteen bans it brought forward and other requirements limit the living space of these platforms by restrict business activities on products that were risky but most profitable and by enhancing their transparency to the public and to the regulators. The changing portion of causes of problematic platforms reflects that the measures do work. More platforms realize that making, or cheating, money in P2P lending market is no longer easy and convenient after the issuance of <<Interim Procedures>>. Consequently, more platforms choose to quit the market before the pressures in operating turn into irredeemable problems. Although the total number of problematic platforms is about 1.5 times in year 2016 than in 2015, the number in 2016 leaving out "Out of Business" types is actually less than in 2015. That is to say, the problematic platform rate has dropped since the enactment of regulations exclusive of the ones that transit or quit automatically. The data in year 2017 are collected by the end of first quarter. Though the numbers are not significant, one variation is outstanding: "Malicious Escape" became the minor cause of problematic platforms; the percentage of "Out of Business" cause is even higher. The trend of increasing automatic exit is expected to continue throughout 2017 and less vicious events like eZu Bao incident are expected to happen in the future in P2P lending market.

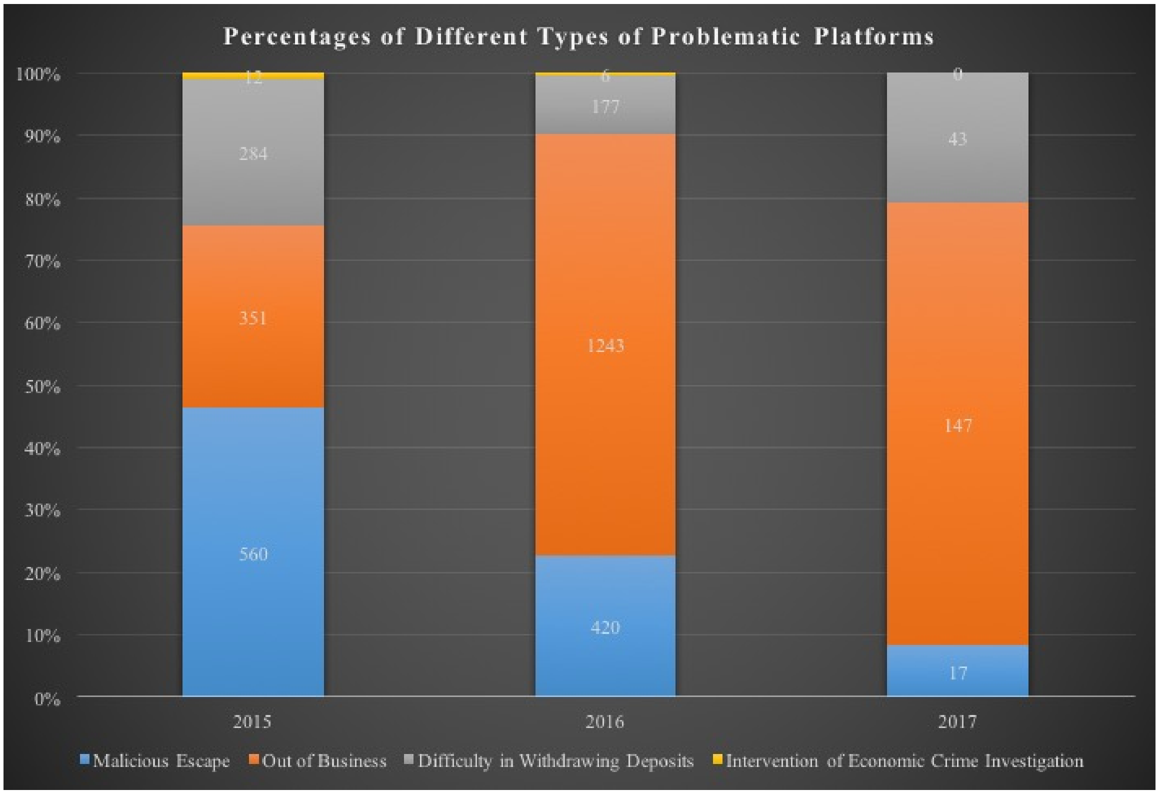


Figure 12[xl]. Percentages of Different Types of Problematic Platforms

An approach around quitting the market is merges and acquisitions. The dilemma the platforms are facing on the enactment of regulations is that it is costly to meet the regulation requirements such as regular audit and report and limiting loan products. Through merges and acquisitions with competitors, the platforms consolidate their resources of assets and customers and in the meanwhile they expand their business scopes. This makes the platforms more competitive in the market and once the profitability goes up, it is less costly to meet the regulations. Therefore, more merges and acquisitions are expected to take place and this trend should be in concert with the increase of automatic exit of platforms.

In the form of negative list management, the regulators show their expectation on further development and innovation in this market. P2P lending businesses involving consumer finance, mortgage loans, supply-chain finance and other related businesses that have been encouraged explicitly by government's promoting plans and project will hopefully welcome further growth. In the meanwhile, a better credit environment is taking shape in the following years. In January 2015, People's Bank of China published a notice on individual credit reference business and in the notice, People's Bank of China distributed the responsibility of individual credit reference companies into eight credit reference companies, including Tencent Credit Services and Zhima Credit (under Alibaba Corp.)[xli]. Credit information collected by the companies covers every detail in the daily life such as negative reviews of online shopping, or complaints from Didi[4] passengers. More importance is attached to technologies of big data and cloud computing which are effective methods of obtaining credit information. In a word, the improvement of credit environment and the openness in other related business will further expand peer-to-peer business into more aspects of customers' life.

**Endnotes**

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