Review

Education & Society

Risks in Online College Student Lending in China and Coordinated Regulation

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DOI: https://doi.org/10.15354/si.23.re122
Funding: No funding source declared.
COI: The author declares no competing interest.

Since its introduction to China in 2007, online lending has witnessed a boom, aided by the impetus of internet development. Due to the peculiarities of the borrowers, online college student loans facilitated by peer-to-peer lending platforms have sparked widespread public concern. Many issues plague online lending operations for college students, including unclear duties of the platform, immature approval and exit regulations, interest rates, and fee structures; knowledge asymmetry in the transaction; and false publicity of the platform for profiteering purposes. As a result, internet lending risks are increasing, including credit risk, usury risk, and information leakage risk. The objective of this research was to provide implications for risk avoidance and action by exploring the causes of these risks and describing the current governance of online student lending.

Keywords: Online Lending Platform; P2P Lending for College Students; Risk Prevention; Financial Regulation

Science Insights, 2023 February 28; Vol. 42, No. 2, pp.807-811.

FOR college students of varying socioeconomic origins, spending capacity varies considerably. Nonetheless, the majority of them come from average families and rely solely on parental allowances for support. Peer pressure may cause kids who lack self-control to develop a taste for material luxuries in the absence of parental monitoring. Due to their curiosity and vanity, individuals may spend their money on luxuries rather than necessities.

The China Banking Regulatory Commission issued the Notification on Further Regulating the Credit Card Business in 2009, mandating that financial institutions are prohibited from providing credit cards to students younger than 18 years old (1). It also placed restrictions on marketing credit cards to college students. In this context, the majority of licensed financial institutions withdrew their credit card operations from college campuses, while numerous internet lending organizations capitalized on the situation to market their services to college students. Relative to conventional finance operations, online lending services have a significantly lower loan origination threshold because they do not require a credit or asset guarantee. As a result, online loans to college students have undergone tremendous expansion, accompanied by the emergence of hazards.

There are different kinds of online lending for college students, but the most typical form is an online loan based on peer-to-peer lending (also known as P2P lending) platforms. In this article, the practice of lending money to college students through online P2P platforms to meet their needs for financial services is referred to as "online college student lending" (2). This practice involves completing the transaction between individuals without the traditional "middlemen"—the mainstream financial institutions. In this context, "individuals" refers to both the investors and the borrowers (college students) (3). In other words, online lending to college students operates under the premise that the online platform acts as an informational mediator, matching lenders with borrowers, and that it assumes no responsibility for credit risk. Due to the unique characteristics of borrowers and the purpose of the loans (mainly for entertainment consumption), online loan services for college students are more vulnerable to risks and crises than other lending operations.

Risks in Online College Student Lending

The Credit Risk

Credit is crucial to financial activity, in which the borrower has both the right to use and the duty to repay funds. Nonetheless, college students are often prone to impulsive and irresponsible consumption; thus, college student lending was once one of the most rapidly expanding products of P2P financing. In 2015, the Credit Management Research Center (CMRC) at Renmin University of China recruited 187 credit management majors from 22 Chinese colleges to conduct a study of roughly 50,000 college students from 254 higher education institutions. The survey yielded a report titled "Study on Chinese College Students' Knowledge of Credit" based on 29493 valid responses (4). In times of financial necessity, 8.77% of college students would turn to loans, over half of which were secured via online platforms, according to the findings of the study. According to Zhu's study, college students can easily obtain a loan by providing personal information online, receiving approval, and paying a processing charge in online lending, are often prone to impulsive and irresponsible consumption; thus, college student lending was once one of the most rapidly expanding products of P2P financing. In 2015, the Credit Management Research Center (CMRC) at Renmin University of China recruited 187 credit management majors from 22 Chinese colleges to conduct a study of roughly 50,000 college students from 254 higher education institutions. The survey yielded a report titled "Study on Chinese College Students' Knowledge of Credit" based on 29493 valid responses (4). In times of financial necessity, 8.77% of college students would turn to loans, over half of which were secured via online platforms, according to the findings of the study. According to Zhu's study, college students can easily obtain a loan by providing personal information online, receiving approval, and paying a processing charge. More than forty percent of them have used loans or installment payments at least once (5) when their parents' monthly allowance is insufficient to cover their exorbitant expenses. Despite the fact that some students may attempt to supplement their income with a part-time job, such revenues are typically low and unstable, and loan repayment remains challenging, resulting in missed payments and even loan defaults. In addition, some borrowers may go to great lengths to obtain money from lending organizations by exploiting their web platforms' flaws, such as applying for loans using the identities of others (6).

The majority of online lending platforms prioritize finding ways to increase the fees they receive for connecting borrowers and lenders. Many financial institutions launched online lending services during the early days of high profits in an effort to capture a portion of the industry. Most of these services are vulnerable to capital chain breaks because they have insufficient capital strength and limited risk management capabilities. For instance, Youyi, an online lending platform, went from opening its doors to closing them down with its actual owner missing in just four months in 2012. As a result, the individual investors suffered losses of up to 20 million CNY (7).

The Risk of Usury

According to the Provisions on Several Issues Concerning the Application of Law to the Trial of Private Loan Cases, published by the Supreme People's Court of the People's Republic of China in August 2015, the annual interest rate must be no higher than 24% to be protected by law; interest rates between 24% and 36% are in the gray area, and the lender is not required to return the settled amount; annual interest rates above 36% are not protected by law, and the borrower has the right to sue (8). The online loan site might purposefully hide the interest rate, preying on college students' lack of familiarity with the essential legal issues. Only approximately 20% of the loan rates on more than 80 online financing platforms were made explicit in 2016, according to an inquiry into their lending rates (2). Some of the platforms that do provide interest rate information may list extremely low rates (which are actually daily or monthly interest rates). This is a trick pulled on the students. The initially low interest rate may later rise to an exorbitant sum.

Online lending platforms may also use hidden fees to boost their profits in addition to interest rate manipulation, which makes it simple to circumvent legal restrictions. Some dishonest internet lenders may entice students with favorable lending rates in order to close the deal, but they later add more requirements and charge extra costs (10). In a vicious cycle, borrowers who are unable to pay off their growing debts turn to other websites for additional loans to make up the difference.

The Risk of Information Leakage

When registering for online lending platforms, students must supply personal information such as their name, contact information, ID number, and home address. Although the platforms are required by law to protect the privacy of their consumers, some delinquent loan businesses continue to exchange students' personal information for extra profit. To attract more investors, several online lending operators have declared the "transparency of information" principle, which permits investors to check the borrower details of each loan. This significantly raises the likelihood of information leaking. Worse yet, some online lending organizations may threaten to publish a student's personal information in order to coerce missed repayments.

In addition to delinquent loan businesses intentionally disclosing customer information, network hacking technology is also to blame for borrower data leaks. Online lending platforms, in contrast to traditional financial institutions, are fully reliant on the internet, which makes them more vulnerable to network hacker attacks (especially those that exploit technological flaws). Customer data may be compromised or disclosed after such assaults (2).

Causes of Risks in Online College Student Lending

Information Asymmetry

P2P online lending services connect investors and borrowers to facilitate the flow of funds. The three parties have principal-agent relationships with one another. Borrowers and investors must utilize the platform as an intermediary because they are unable to connect directly (10). In the online student lending market, investors have no opportunity to understand the goals of student loans, let alone manage their spending habits, so the latter's profits are totally dependent on the former's ability to maintain self-control. Due to the effect that disclosed personal situations have on the loan interest rate, borrowers may decide to withhold or distort facts. It makes it more challenging for investors to choose wise investments. Additionally, the knowledge asymmetry between investors and borrowers is made worse by the absence of an acceptable information disclosure system on the part of online lending platforms.

The Ambiguous Role of P2P Online Lending Platforms

The online lending platform should act as an information intermediary, also known as the middleman, in the transaction, according to the Interim Measures for the Management of the Operation of Online Lending Information Intermediaries (hereinafter referred to as the Interim Measures) published by the National Internet Finance Association of China (11); With the growth of the market economy, China's online lending platforms have evolved four models: the intermediary model, the model of assignment of creditor's rights, the guarantee model, and the insurance model.

Since the spread of online lending to college campuses, it has been modified to reflect the consumption patterns of college students. Presently, there are three primary types of online lending for college students: the online buying platform based on college students' consumption behavior (often permitting payment in installments), the online platform providing cash and non-cash loans, and the common credit service. Regardless of the model it follows, the online student lending platform has begun to deviate from its original purpose, which was to simply provide a platform for information exchange and credit evaluation between the two parties of the transaction, as opposed to being a financial institution or credit intermediary.

Nowadays, some online student lending platforms in China are acting as credit intermediaries and financial institutions while masquerading as information intermediaries. They execute credit transformation and guarantee functions in addition to supplying information and become involved in the transaction between the investor and the borrower. The platforms' absconding with investors' cash and the breaking of the platform's capital chain as a result of their direct money investment are the results of such actions.

Fake Publicity

Several online lending platforms use misleadingly cheap loan prices in their marketing to deceive students to increase their market share and draw in more consumers. Fake publicity includes the following: (i) Students are initially offered loans with no interest, but in reality, the interest is replaced with other costs, such as service fees, handling charges, etc.; (ii) There is no guarantee or deposit required, but a portion of the loan is taken to serve as the deposit, reducing the amount that students ultimately receive; and (iii) There is no mention of the repercussions of late repayment. In reality, once the repayment is past due, students must pay a steep penalty (12).

Immature Approval/Exit mechanism, Regulatory System, and Interest Rate and Fee Framework

The licensing process for China's internet lending platforms has shifted from laissez-faire to filing and registration. The publication of the Interim Measures marked the commencement of the industry's official regulation. Yet, as a result of the advent of the internet, online lending has expanded beyond geographical boundaries. Internet lending platforms are typically registered in jurisdictions with minimal approval requirements. Even though there are relevant rules in place regarding the exit of online loan platforms, the fact that a significant number of them have absconded with investor funds reveals severe loopholes in the exit mechanism, indicating the absence of a unified domestic system and the urgent need to increase the level of legalization in this area (13).

The Interim Measures offer some recommendations for regulating online student loan platforms, but they do not have much application in the market because most of the borrowers are college students without stable sources of income. Most student loans by far exceed the borrowers' capacity to repay them and do not adhere to the terms of the Interim Measures. The current regulatory system does not adequately address the unique characteristics of college student online lending, which should be addressed differently from general private loans. It also does not adequately monitor personal information security in the internet environment or take effective coping measures against illegal, violent ways of collecting repayments in colleges and universities (14).

College students are now forced to turn to online lending platforms with lower thresholds after the China Banking Regulatory Commission published its Notification on Further Regulating the Credit Card Business in 2009, discouraging them from obtaining loans from banks and other traditional financial institutions. The regulations on lending interest rates and fees charged by online loan platforms are not, however, included in the Interim Measures. Due to the opportunity to increase interest rates to usurious levels, which can range from 20% to 40% of the principle, some online lending companies may do so (15).

The Current Governance of College Student Online Lending Platforms

Governance through Policies

The incident of "loans with nude images," which involved a platform using nude pictures of student borrowers to secure repayment, was made public in 2016, which caused the appropriate regulatory authorities to take steps to further control the operation of online student lending platforms. The *Notice on Improving the Education and Prevention of the Hazards of Online College Student Lending*, released that same year by China's Ministry of Education and China Banking Regulatory Commission, marked the start of a national policy-based regulatory framework. The Work Notice on Further Strengthening the Governance of College Student Loans, published in May 2017 by China's Ministry of Education, Ministry of Human Resources, and Ministry of Social Security, stipulated that institutions operating on college campuses without the approval of regulatory departments must stop lending to students; those that must continue operating must make the necessary adjustments to their operations and propose the exiting time. The three points listed below are prioritized by the existing regulations on online student loans: multi-agency collaboration; oversight of the functioning of online platforms; and participant education and advice (16).

The China Banking Regulatory Commission first outlined the roles of P2P platforms in 2014. These roles included intermediaries without capital pools and the capacity to provide guarantees, as well as being forbidden from "illegally obtaining funds from the public." 2015's Interim Measures made it even clearer that the online lending platform could only act as a conduit for information and couldn't offer its own guarantee, but that third parties might.

One of the primary targets for the specific rectification of P2P lending in China is online college student loans. The China Banking Regulatory Commission, the Ministry of Education, and other relevant departments have collaborated to strengthen the response to risks in college student online lending. According to the Annual Report of China's Online Lending Industry 2019, almost 700 platforms quit the business that year, including over 500 sites that were suspended or changed and over 200 platforms that had severe problems (17). Clearly, the application of key policies has been effective in regulating the industry. Unfortunately, the risks associated with online lending have not been erased, and new pitfalls, such as the "cancellation of college student online loan accounts," have surfaced.

The Status Quo of Social Responses to Risks in College Student Online Lending

Responses to the Risks of Information Leakage

In 2019, the Supreme People's Court and the Supreme People's Procuratorate issued the *Interpretation of the Supreme People's Court and the Supreme People's Procuratorate on Several Issues Concerning the Application of Law in Criminal Cases*, including *Illegal Use of the Internet and Assisting in Internet Crimes*, which established comprehensive and systematic sentencing criteria for the crimes of unlawful use of the internet. This document gives rules for the application of criminal law to cybercrimes. Once the number of online student lending platforms was drastically reduced in 2020, new network frauds such as "cancellation of college student online loan accounts" arose continually. More than 288,000 pieces of negative news regarding online lending fraud were reported in the first half of the year, of which roughly 93,000 were about the "cancellation of college student online loan accounts," accounting for 32.14% of the total number of frauds. Using information gathered from online loan platforms such as Fenqile and 360 IOUs, criminals committed fraud (18). One of the techniques consisted of identifying individuals who had registered accounts on the online lending platform and notifying them to "help with canceling their accounts with the platform in accordance with applicable national rules." These con artists were able to precisely reference the victims' personal information in order to lessen their alertness and rob their bank accounts. These instances of fraud were a result of information leaking on the part of online lending platforms. Untrustworthy online lending platforms sell customer information, which is subsequently used by criminals to commit fraud, constituting a chain of illegal activity.

Responses to the Risks of Credit and Usury

Several borrowers intentionally avoided payments and obligations throughout the rectification time while the appropriate authorities accelerated the suspension of non-performing platforms in the industry. The frequent occurrence of such lawsuits has significantly slowed down the legal closure of unqualified platforms and prevented the effective execution of pertinent national legislation. A report from the 21st Century Business Herald claims that in 2018, P2P platform-dodged debt accounted for 15% of the overall amount owed, and the platforms' bad debt percentage skyrocketed to between 13% and 15% (19).

In compliance with policy criteria, online student loan platforms that choose to reform or update their operations now prioritize the provision of the two financial services listed below: (i) consumption based on payment in installments. Students choose the products displayed on the site and pay for them in installments so that they do not have access to cash. Popular products include digital devices, travel, education, and more; (ii) cash advances, which are often returned in predetermined installments. The promotion of these financial products is a reaction to the issue of "the online lending platform establishing its own money pool," but the original hazards of credit and interest cannot be eliminated. Using "the loan for beauty services" as an example, certain online lending platforms collaborate with beauty treatment institutions to create beauty loan services for female college students under the advertising slogans "high quality, low price, and simple repayment." Typically, such loans are based on deceptive contracts and stringent repayment terms, and the borrowers become victims of usury. As "lending traps" have not been precisely defined by law for a long time, it is challenging to criminalize them. The April 2019 release of the Opinions on Many Matters Concerning Criminal Cases of "Lending Traps" gave legal backing for the prosecution of such offenses (20).

Conclusion

It is not advisable to forbid online lending companies from giving loans to college students in the "internet plus" era. The one-size-fits-all approach to prohibiting online student loans could be ineffective because it could encourage the growth of illicit platforms and leave college students with unmet financial needs. A coordinated financial regulation framework should be in place to ensure equilibrium between the rising demand for online lending among college students and the development of sound online lending platforms. Industry volatility may result from competition, but it may also force the sector to adapt. A noteworthy example is the founding of the Online Credit Service Industry Association in Shanghai. Nevertheless, competition by itself lacks the strength to sanitize a business (21). A multi-agency financial regulation mechanism is essential to the thorough prevention of risks in online student lending; the development of an information-sharing platform and a system for checking college students' credit can successfully reduce the credit risk of online student loans and protect the interests of all parties; the establishment of an approval and exit mechanism, an industry association, and a financial regulation system can significantly reduce the risk of usury and information leakage and help build a healthy environment for the industry.■

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Received: December 19, 2022 | Revised: January 17, 2023 | Accepted: January 29, 2023