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Peer-to-Peer Financing: A Lifeline During the Pandemic?

The recent imposition of Movement Control Orders to combat the COVID-19 pandemic has, without a doubt, hampered economic recovery in Malaysia. The sustainability of businesses — particularly that of small and medium-sized enterprises (SMEs) — is invariably at risk. One suggestion to alleviate the problems faced by vulnerable SMEs has been to encourage and improve access to peer-to-peer (**P2P**) financing.¹

This alert provides an overview of: (i) what P2P financing entails; (ii) the regulatory framework governing P2P financing as well as (iii) a recent High Court case concerning P2P financing, *Pyo Travel*.²

What is P2P financing?

P2P financing, or P2P lending, is a form of crowdfunding which allows businesses to obtain capital directly from lenders without the involvement of financial institutions. The lenders here comprise of retail or sophisticated investors.

P2P financing promotes financial inclusivity by enabling loans to borrowers who have been unable to receive financial support from conventional banking facilities due to their low credit-ratings.

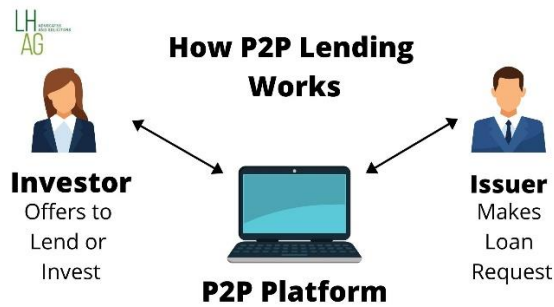
How does P2P financing work?

In Malaysia, P2P financing is carried out on online P2P platforms operated by P2P operators. All P2P operators are required to be registered with the Securities Commission.³

¹ Jerry Choong, "Industries Unite lay out detailed alternative strategy for Government to handle Covid-19", *Malay Mail Online* (30 June 2021) <https://www.malaymail.com/news/malaysia/2021/06/30/industries-unite-lays-out-detailed-alternative-strategy-for-government-to-h/1986142> (accessed 6 July 2021)

² *Pyo Travel (My) Sdn Bhd & Anor v Modalku Ventures Sdn Bhd* [2020] MLJU 575

³ Capital Markets and Services Act 2007, s 34



The process of P2P financing is more flexible — having less red tape in contrast to conventional bank loans. A prospective borrower (known as an “**Issuer**”) first completes an application on the relevant P2P platform, which will be assessed by the P2P operator. Upon approval, an investment note will be issued and hosted on the P2P platform.

An investor will then make an informed decision on which investment note to invest in, and on the amount that he or she plans to invest, based on information published on the P2P platform. This information will usually include the Issuer’s business, financing purpose, financial information, credit assessment, repayment schedule and risk profile.

In conventional banking, the loan’s terms are usually standardised and applied equally across the customer base. P2P financing, however, allows for customisable loan terms and competitive interest rates based on the Issuers’ needs and risk profile.

An Issuer will be allowed to retain any amount which has been raised on a P2P platform once it has successfully raised at least 80% of the target amount. All successful Issuers are then required to comply with the repayment scheme as per their contractual arrangements with the P2P operators and/or the investors.

How is the P2P regime regulated?

P2P financing is exempted from the provisions of the Moneylenders Act 1951.⁴ The regime is instead governed by the Capital Markets and Services Act 2007, and regulated by the Securities Commission. Below is an overview of some of the relevant laws and regulations:

For P2P operators

- (a) All P2P operators must be locally incorporated and have a minimum paid-up capital of RM5 million;⁵
- (b) P2P operators must: (i) ensure that there is an effective

⁴ Moneylenders Act 1951, s 2A(1), and First Schedule at para 12
⁵ Guidelines on Registered Markets, Chapter 14, para 14.04

and transparent risk-scoring system; (ii) inform investors of any material adverse changes to the issuer's proposal; (iii) set a debt-recovery regime; and (iv) ensure that the Issuer's documents are verified for accuracy and made accessible to prospective investors;⁶

- (c) P2P operators are required to establish and maintain a trust account with a licensed institution, which is designated for funds raised on the platform, and for monies received as repayment to investors.⁷

For Issuers

- (a) P2P financing is only available to locally incorporated or registered sole proprietorships, partnerships, limited liability partnerships, private companies and unlisted public companies.⁸ It is not available to individuals;
- (b) Issuers are not permitted to retain any funding which exceeds the initial target amount;⁹
- (c) Issuers must also comply with disclosure requirements pertaining to: their intention to seek funding from any other P2P platforms (borrowers cannot be hosted concurrently for the same purpose on multiple P2P platforms); details of the issuer's business plan, etc.¹⁰

P2P financing in court

In 2020, the High Court acknowledged the legality of P2P financing in *Pyo Travel*.¹¹ This case concerned two civil suits filed by a P2P operator against borrowers who had defaulted on their repayment scheme. The borrowers argued, among other matters, that the financing agreement was illegal on the ground that the P2P operator and investors were not licensed to provide such financing facilities.

The High Court found that the financing agreement constituted a valid P2P financing arrangement, and that the plaintiff was a Recognized Market Operator registered with the Securities Commission. The court also held that the interest rate of 15% per annum provided for under the P2P financing agreement was reasonable. The financing agreement was therefore upheld accordingly.

⁶ Guidelines on Registered Markets, Chapter 14, para 14.05
⁷ Guidelines on Registered Markets, Chapter 14, para 14.09–14.15
⁸ Guidelines on Registered Markets, Chapter 14, para 14.19
⁹ Guidelines on Registered Markets, Chapter 14, para 14.28
¹⁰ Guidelines on Registered Markets, Chapter 14, para 14.29
¹¹ *Pyo Travel (My) Sdn Bhd, supra n 2*

Conclusion

Despite the regime being relatively new in Malaysia, the P2P financing industry has seen substantial growth.¹² Given the high number of transactions on P2P platforms, disputes regarding P2P financing may become increasingly commonplace. Parties encountering such disputes are therefore encouraged to proactively seek legal advice so as to preserve and protect their legal rights.

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¹²

Kuek Ser Kwang Zhe, "P2P financing industry growing", *The Edge Malaysia* (26 December 2019) <https://www.theedgemarkets.com/article/cover-story-p2p-financing-industry-growing#:~:text=The%20local%20peer-to-peer%20%28P2P%29%20financing%20industry%20has%20seen,2%C2%BD%20years%20since%20the%20first%20platform%20was%20launched> (accessed 6 July 2021)