How credit platforms may make bank loan caps ineffective

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Authorities often resort to bank loan regulation when the housing market overheats. The emergence of lightly regulated online intermediaries, however, can make it harder to curb speculation.

Chinese homebuyers routinely use informal credit providers to circumvent regulations intended to cool down the housing market, as shown in a paper by Alberto Manconi (Associate Professor at the Department of Finance), Fabio Braggion of Tilburg University and Haikun Zhu of Erasmus University Rotterdam.

The Chinese housing market has been growing very rapidly in the last few years, buoyed in part by speculation. This is a major concern for the country's financial authorities who want to prevent a sudden bust which might lead to mass insolvency.

In 2013, the Chinese government set a limit on amounts homebuyers could borrow from banks, which were thereafter capped at 60% of the property's worth in several locations, introducing what is known as a "loan-to-value" (LTV) limit. This is a fairly common way of containing household leverage, especially since the 2008 crisis.

Consequently, anyone willing to purchase real estate had to provide the remaining 40% of the price upfront, which obviously makes such an operation unaffordable for many. This is precisely the point of the LTV cap, aimed at reducing banks' exposure and curbing speculation. However, individuals may try to make up for the shortfall via less regulated online intermediaries (the so-called marketplace credit platforms) to elude the cap undetected.

The extent to which this has happened is what the paper investigates. These lightly regulated intermediaries usually function as microlenders to small businesses and are not meant to be in competition with actual banks, which is why they were not subject to the same scrutiny.

The authors, comparing evidence from areas where a LTV cap has been enforced with data from a control group of cities where this measure was not introduced, find that, for example, there had been a 31% increase in marketplace loans at the LTV cap cities relative to the control ones.

Furthermore, among loans to homeowners, delinquencies (late payments) increase by 1.6 percentage points, and defaults by 2.4 percentage points, relative to the control cities. Tellingly, no changes in delinquencies or defaults among loans to non-homeowners have been observed.

"Regulators have achieved mixed results," explains Alberto Manconi. "Banks have indeed reduced their exposure somewhat, but the housing market has not cooled down as desired. We can therefore conclude that the spirit of the law was eluded, and that a crash is no less likely following these measures."

The study is published in the journal *Management Science*.

More information: Fabio Braggion et al, Household Credit and Regulatory Arbitrage: Evidence from Online Marketplace Lending, *Management Science* (2022). DOI: 10.1287/mnsc.2022.4592

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