Peer to Peer Lending -The Way ahead

Girish Mainrai*

Introduction

According to Section 5(B) of Banking Regulation Act, 1945, "Banking means the accepting for the purpose of lending or investing of deposit of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise." Thus, according to this definition banks play the role of intermediary between depositors and borrowers. This role of intermediation played by the banks is the very source of disruption being witnessed in the financial sector. Thus, services like money deposit, withdrawal, transfer, bill payments etc. are being offered by niche players like Paytm, Tez from Google, small banks, payment banks and microfinance companies. No one imagined lending traditionally considered as risky, involving risk of default, could be disrupted. This notion that lending can be done only through brick and mortar model is broken by online platform known as P2P lending or peer to peer lending.

P2P lending or peer to peer lending is concept of bringing together fund seekers or borrowers and fund givers or lenders through online medium. The requirements of borrowers and lenders are matched by these online platforms. Thus, in P2P lending the online medium plays the role of intermediary which assist in providing various services like verification, assessment and even recovery. An analogy can be drawn to matrimonial website, wherein prospective brides and bridegrooms register their details like age, work profile, religion etc. According to the requirements the company shortlists the available profile on its website. Similarly, in case of P2P, the borrowers and lenders are brought together by registering on to the site of the P2P player. Now the question arises that with the availability of so many players like banks NBFCs, Microfinance companies why would one borrow directly from individual or company. The answer lies in the assessment of loan by these players as traditional players like banks select borrowers with regular and high income. The business model, process adopted by these intermediaries such as banks naturally create a lacuna, leaving a space for niche P2P platforms to encash on. In India prominent players in the space are faircent Indian money mart cap zest to name a few.

A simple representation of P2P could be as under:

The intermediaries or P2P companies perform a number of functions like e-KYC, verification which includes reference checks, extracting and analyzing credit information reports, ITR's, bank statements and physical verifications also. The other functions include credit risk assessment of the borrowers as it affects the pricing, documentation and agreement through electronic mode. The platform also arranges for insurance covering death, disability or loss of job. The company may also assist in recovery of loans. The model operates on fees charged for the above mentioned services which in turn depends upon the degree/ amount of services availed by the customers.

*Chief Manager, Bank of India.

Difference between Banks and P2P

Though in same line of activity, the model adopted by P2P companies is quite different to that adopted by banks. The difference being as under:

Income - A P2P platform sources its income in the form of fee charged from borrowers as well as lenders, whereas in case of banks, the primary source is the margin or interest income arising as difference between interest income and interest expended. The platform performs host of functions like verification, documentation, recovery etc. entailing income for the platform in the form of fees charged to the customers.

Risk - In case of lending the intermediary is exposed to risk of default, i.e. non-payment of loan by the borrower. In banking, this risk is borne by the intermediaries, i.e. the banks themselves whereas in case of P2P, the risk is not borne by the platform but by the lenders themselves. Though these platforms use a number of risk mitigation tools like insurance, holding cheques and fractionalization to name a few.

Assessment - The other minor difference lies in assessment of loans, for which banks rely heavily on income/cash flow for decision regarding credit dispensation. P2P companies apart from income, leverage technology in decision making rely on psychometrics, online behavior, algorithm technics etc.

Power to choose - The other distinction being that the lender has the power to choose, whether to lend or not to a particular borrower, whereas in the case of banks the money deposited by depositors is lent to borrowers. In a way the depositors have no say in the credit decision as the decision is made by the banks.

The popularity of P2P lending is increasing on account of number of reasons which are as under:

1. Simplicity - This aspect accrues on account of tedious process adopted by traditional players like banks. Banks lend to borrower considering age, income, deposit, existing relationship and involve lengthy documentation. Whereas P2P is simple, going beyond these aspects to identify prospective borrowers. For example, an individual above 65 years of age may be denied a loan by a bank but it is not the case with P2P.

2. Pricing - The other reason for increasing popularity of this platform is the potential for offering premium to both lender and borrower. Both can expect good returns as the model operates through online medium thus, reducing operating costs contrary to brick and mortar model of traditional banking.

3. Speed - P2P companies have the potential of offering low TAT (Turn Around Time) as they leverage technology at all stages from registration to final agreement thus enabling speed in whole process.

Regulatory Model

The regulation of P2P ranges from exempted to fully prohibited in some countries, which is as under:

1. **Unregulated** - Either P2P activity is not regulated or it is not defined, example -China and Ecuador.
2. **Intermediary regulation** - In this type, regulation of platform is an intermediary, example- Australia, North Korea.
3. **Banking Regulations** - On account of their lending activities, P2P platforms are regulated as banks example being France, Germany and Italy.
4. **US Model** - In this type the regulation is at twin level at Federal and State level classic example being USA.
5. **Prohibited** - The P2P activity is completely banned. For example - Israel and Japan.

RBI directions on Peer to Peer Lending

RBI issued directives under NBFC Peer to Peer Lending Platform (Reserve Bank) Directions 2017 Dated October 04, 2017 (updated as on 23/02/2018), according to which the net owned fund of the company engaged in P2P lending should not be less than ₹20 million. There are certain restrictions

imposed like NBFC P2P cannot lend on its own, not provide any credit enhancement or guarantee, nor engage in cross selling of any product and not allow international flow of funds. These directions laid exposure norms for lenders as well as borrowers. The lending exposure of a particular lender cannot exceed Rs 10 lakhs, similarly the loans taken by a borrower is subject to a limit of ₹10 lakhs across all platforms. The exposure of a lender to a same borrower cannot exceed ₹50,000/- across all P2P's.The tenure of the loans can be maximum 36 months. The companies engaged in P2P are mandated to submit data to all CIC's (Credit Information Companies). These directions also lay down disclosure norms both for lenders and borrowers like amount, ROI (Rate of Interest), details about lender and borrower, etc.

Conclusion

P2P lending is at a nascent stage but the activity is steadily picking up as the awareness about it is increasing. The simplicity, flexibility and accessibility aspects are the reason for its growing popularity. Globally the growth of P2P lending is contagious as more and more countries are adopting and promoting this activity. This is evident as many studies have reported phenomenal growth of P2P lending. As per stasicica.com, the P2P activity is slated to touch one trillion U. S. dollars by 2050. P2P lending has the potential to disrupt lending business on account of its inherent simplistic structure. This activity though having high element of risk, is not dithering investors from venturing into it on account of high upside potential. The investors are willing to take risk for higher returns. The platform on its part is managing risk through mitigants /measures like insurance, fractionalization, strict verification etc. No one imagined that companies like OLA and Uber can run transportation business without owning the vehicles. In same parlance no one imagined that lending can be carried out without accepting deposits or borrowing of funds.

References

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