SUSTAINABILITY OF PEER TO PEER LENDING

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ABSTRACT

Peer-to-Peer Lending (or P2P Lending or Crowdlending) has turned out to be a recent financial innovation. With close to 30 percent CAGR growth in market size, the global P2P market stands at $67.93 billion as of 2019. Peer to peer lending process connects lenders and borrowers through online lending platforms. The platform itself earns a small fee out of the transaction. Individuals who need money urgently can borrow from a pool of individuals ready to lend at a fixed rate of interest through an online platform.

This chapter explains the definition and evolution of P2P loans, particularly in the Indian context and the regulations stipulated by the Reserve Bank of India (RBI), the pros and cons of different P2P lenders. We then examine the impact of COVID-19 lockdown and restrictions on the lending practices and sustainability of the lending platforms. Secondary data from sources reported online as well as offline were used in this analysis.

KEYWORDS: credit market, debt financing, escrow account, unsecured loans, EMI payment

JEL CLASSIFICATION: G23, G24, F34, F33

CITE THIS ARTICLE: *Devarajan, Monisha., Sasidharan, Saranya. (2020, September).* Sustainability of Peer to Peer Lending*. In Perspectives on Business Management & Economics (Vol. II, pp. 37-45). Retrieved from http://www.pbme.in/papers/40.pdf*

ARTICLE HISTORY: Received: July 18, 2020; Accepted: September 8, 2020; Published: September 30, 2020

1. INTRODUCTION

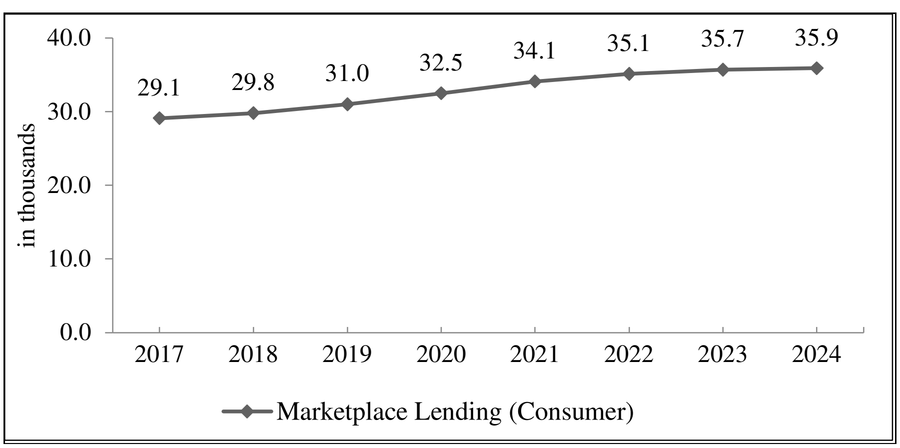
Technology advancement and extensive use of electronic gadgets by consumers and financial institutions have reshaped the financial services sector at a hastened pace. It has been converging to drive the FinTech market, integrating *finance & technology* to meet the banked and unbanked population's varying needs. The FinTech market is enriched with various

ISBN: 978-81-947738-1-8

products to automate almost all financial sectors, including banking, investment, insurance, trading, and Robo-prompting. Peer-to-Peer lending (or P2P lending or social lending) is one of the benefactions of FinTech in the banking sector. It makes the use of an online platform which connects or matches borrowers pursuing unsecured loans and lenders anticipating higher return for their investment, in return for a fee. (Alistair & Parboteeah, 2016)The lending websites operated by various companies are known as the P2P platform. Any individuals or a legal person who is listed in the P2P platform can borrow money from individual investors or financial institutions for a pre-determined rate of interest. It is similar to the traditional banking system's lending function and refurbishes it to mold customer-friendly lending and borrowing atmosphere by eliminating financial institutions or intermediaries. It is working, and upkeep costs are low because the whole administrations of P2P organizations were rendered on the web. (Eugenia, 2018) Further, early adoption of new disruptive technologies such as blockchain will give a sustainable edge to them going forward. (Vijaya Kittu & Satyaprakash, 2019)

In India, P2P advancing set up its stem with I-LEND's introduction as a technology-driven credit market in 2012, after which more than 30 companies entered in this industry. (Shivangi, 2019) From 2016 onwards, the Reserve Bank of India (RBI), takes the initiative to shelter the interest of parties involved in the P2P business. As part of it, issued guidelines in October 2017 have directing P2P platforms to be Non-Banking Financial Companies (P2P-NBFCs) by obtaining a Certificate of Registration (CoR). So, these NBFCs are under the gamut of RBI and mandatory to submit reports. It paves the way to attract new participants and makes existing members more secure. (Vinod Kothari Consultants, 2017). The following figure shows the number of successfully funded and expected alternative loans in India.

FIGURE 1: NUMBER OF SUCCESSFULLY FUNDED AND EXPECTED ALTERNATIVE LOANS IN INDIA



Source: Statista (Forecast adjusted for the expected impact of COVID-19), May 2020

OBJECTIVES OF THE STUDY

1. To evince the evolution and definition of P2P advances in the Indian context.
2. To perceive the regulations stipulated by the Reserve Bank of India.
3. To apprehend the pros and cons of P2P lenders.

ISBN: 978-81-947738-1-8

4. To recognize the overall impact of COVID-19 and the sustainability of P2P platforms.

SOURCE OF DATA

Secondary data from sources reported online as well as offline was used in this analysis.

DISCUSSION

P2P LENDING – AN OVERVIEW

EVOLUTION: A genuinely late wonder, elective financing got consideration with the startup and fintech blast of the mid-2010s. Banks reacted to the interruption challenge by grasping new advancements yet could not pick up as a result of one central explanation - new companies have adaptable plans of action. In contrast, banking guidelines are inflexible and very much directed. Early P2P stages included loaning inside known companions' hover along these lines.

The trust factor is not a significant criterion because members (mostly) knew each other and belong to the same social group. As the lending circle becoming bigger, the trust might not be that strong. Added loan ticket size too began to increase, highlighting the importance of intermediaries and third parties coming into the equation—this increased cost and time in the overall lending process.

The first peer-to-peer loans were underwritten in the United Kingdom in 2005. The concept soon moved to the United States and Korea (2006) and later to other countries such as China and Sweden (2007), Israel (2011), Australia and India (2012), Ireland (2013), Indonesia, Bulgaria, and Canada (2016), Latvia and Brazil (2018), Zopa (UK), Prosper (US), Smava (Germany), I-LEND (India), We Lab (Hong Kong), Society One (Australia), Trust buddy AB (Sweden), Linked Finance (Ireland), and Money Auction (Korea) are the first p2p lenders in their respective regions.

With a 51.5 percent CAGR growth globally, P2P lending is currently the fastest-growing segment in the finance industry. Market estimates that it will reach the US $460,313 million by 2022, with the US $15.98 billion lendings in loans (as of December 31, 2015). Lending Club is the world's largest p2p lending company and the first such company to get listed on stock exchanges. Upstart, Funding Circle, Prosper Marketplace, CircleBack Lending, and Peer form are some category leaders.

DEFINITION: "P2P lending is a type of debt financing with the use of an online platform that connects or matches borrowers pursuing unsecured loans and lenders anticipating higher return for their investment, in return for a fee."

C. WORKING: The P2P credit market is entirely different in structure and working from the traditional bricks and mortar financing system.

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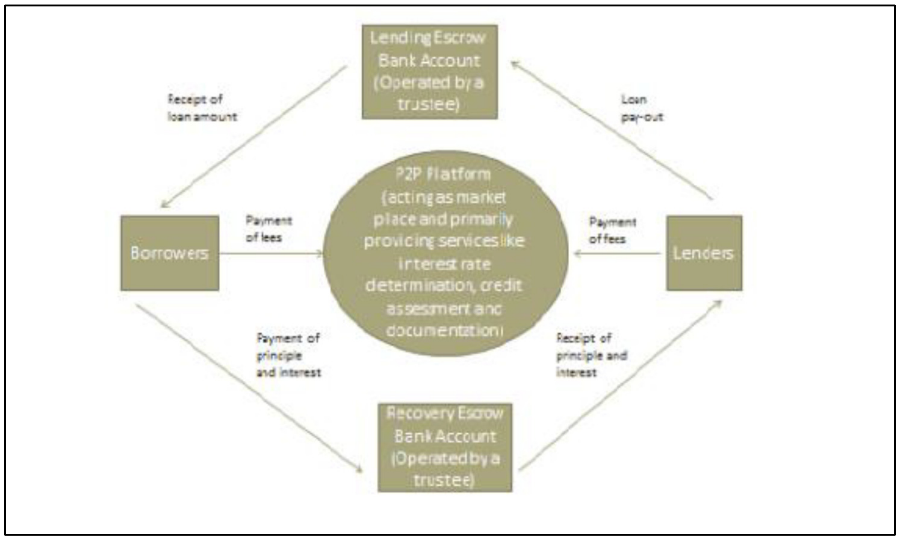
FIGURE 2: FUND TRANSFERRING MECHANISM IN THE P2P MARKET



Source: CARE Rating

REGULATION OF THE RESERVE BANKING OF INDIA

The Reserve Bank of India issued a master direction known as Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017, on August 24, 2017. It provided a framework for the registration and operation of Non-Banking Financial Companies that carry Peer to Peer lending business in India.

Table 1: Key Areas of RBI Regulation

KEY AREAS OF THE DIRECTION	EXPLANATION
Registration	It is mandatory to obtain a Certificate of Registration (“CoR”) from RBI to commence or carry the P2P lending platform as NBFC-P2P (Non-Banking Financial Company – Peer to Peer Lending Platform). Having a net-owned fund of rupees twenty million or such higher amount as the RBI may specify can only apply for registration.
Permissible Activities	Act as a mediator to provide an online credit marketplace to the players of P2P lending. Ensure compliance of legal requirements by the participants, hoard, and information processing relating to the activities and participants. Undertake documentation of loan agreement, the credit assessment, and the borrowers' risk profiling disclose the same to the lenders. Also, render services for the disbursement and repayment of loans.

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Non-Permissible Activities	Accepting deposits, lending its fund, providing any credit guarantee, allowing the international flow of funds, and trading of any products except loan specific insurance products.
Prudential Norms	Shall keep a leverage ratio not higher than 2. A single investor can make the maximum limit of investment to all borrowers across all P2P platforms is ₹50,00,000. The lender investing more than ₹10,00,000 compulsorily submit a certificate from a practicing Chartered Accountant certifying that the lender's minimum net worth is ₹50,00,000. ₹10,00,000 is the maximum amount of loan taken by a borrower across all P2P platforms at any point in time. ₹50,000 is the maximum amount of loan disbursed by a single lender to the same borrower (across all P2Ps). The maximum duration of a loan is 3 years.
Operational Guidelines	All NBFC-P2P have a board policy of its own relating to fixing the eligibility criteria of participants, determining the pricing of services rendered, and forming rules for matching lenders with borrowers in a non- discriminatory basis.
Fund Transfer Mechanism	In peer-to-peer lending, funds transfer between participants is made only through escrow accounts operated by a bank promoted trustee. P2P platforms maintain at least two escrow accounts, one account for accrue funds from investors, and the other for collection from borrowers.
Grievance Redressal Mechanism	Every P2P platform strictly follows a board-approved policy to address the complaints of the participants. Complaints shall be disposed within the time as per the board's approved policy, but in any case, not exceed one month from the date of receipt.
Transparency and Disclosure	NBFC- P2P shall disclose the following: To the lender: details about the borrower including personal, the amount needed, the acceptable range of interest rate, credit score given by the platform, terms, and conditions of the loan. The borrower details the lender/s, including the proposed amount, the interest rate offered but excludes personal identity and contact information. Publicly on the website: an overview of credit rating method, grievance redressal system, disclosure about the security of data, and business model followed.
Reporting Requirements	The RBI may, from time to time, prescribe NBFC-P2P submit return/s.

	Quarterly statements showing details of the loan, balance in the Escrow Account, details regarding grievances, and leverage ratio shall be submitted to the Regional Office of the Department of Non-Banking Supervision of the RBI within 15 days after each quarter.
Supervision	The RBI can inspect any NBFC-P2P at any time by its officer/s or by an approved agency.

Source: Author compilation

PROS AND CONS OF P2P LENDERS

PROS

1. **REGULAR AND PREDICTIVE RETURN:** Borrowers make repayment as EMI, and the lender knows the amount of EMI in advance.
2. **ATTRACTIVE RATE OF INTEREST:** Gets a higher rate of return in proportion to the risk they bear.
3. **EASY TO ENTER AND OPERATE:** Because everything is done online.
4. **TRANSPARENCY:** Details about borrowers with credit score, rate of interest, maturity period, and loan agreements are available in P2P platforms.
5. **CHOICE:** Lenders choose to fund the borrowers that match their preferences.
6. **DIVERSIFICATION**: Lenders can diversify investments across multiple borrowers and thereby, reduce the risk.
7. **NO ARBITRATORS**-: The whole process is done through a virtual platform.

CONS

1. **LACK OF SECURITY AND SAFETY**: The investments are unsecured.
2. **TAX BURDEN**: Interest earned from P2P platforms is taxable.
3. **HIGH RISKS OF DEFAULT**: The lenders are exposed to the risk of default by borrowers.
4. **TIME-CONSUMING**: Creating an optimum portfolio in P2P platforms consumes time.
5. **FEES:** Some P2P platforms charge registration and additional fees from lenders.

IMPACT OF COVID-19

The Covid-19 pandemic has brought the world as we know it to its knees. While most sectors got adversely impacted, the altered dynamics have thrown open new opportunities for certain other sectors. Online lending is one such sector that has been agile and responsive to changes. This crisis has uncovered the gaps in traditional banking and financial institutions, which either ceased or severely curtailed lending during the lockdown. Hamstrung by outdated processes, they still depend on physical processing, verification, and disbursal of loans, which was no longer possible in the era of Janata curfew and social distancing. As a result, P2P lending is likely to rise faster than most in the post-COVID-19 era.

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LOANING POST-COVID-19

In the post-COVID-19 time, there will be a change in perspective regarding all parts of loaning, regardless of whether it is requested and gracefully of credit or the cycles that empower it.

The disappointment of obligation assets and value to endure this stun will drive Indians with surplus assets to go to elective speculation openings, for example, P2P loaning. Simultaneously, as limitations ease, interest for credit to empower financial recuperation will rise exponentially.

'The Greater part of individuals is at home under countrywide lockdown. This has stifled the interest for utilization, prompting less interest for advances. When monetary exercises continue, utilization will go up, thus will the interest for advances. A comparative circumstance has occurred with financial specialists too. When the financial course is back in the economy, more speculators will return with significantly more cash. Right now, we are encountering drowsy credit requests, not the absence of speculation intrigue," says Bhavin Patel, Founder, LenDenClub. Faircent sees the interest to support post the lockdown, yet borrowers having a place with dangerous portions may see the absence of financing interest. "As commonality is reestablished and financial movement recuperates, most organizations will require credit backing to recover financially. With this, the credit request will increment strongly. It should be organized in a way that guarantees effective financing by loan specialists. Credit assessment will be affected by how COVID-19 has affected the borrower. For instance, moneylenders may begin loaning dependent on COVID zones, as opposed to PIN codes, while workers of stress parts, for example, aircraft and lodgings, could be influenced when looking for advances," says Rajat Gandhi, Founder, and CEO, Faircent.

Most players, including Faircent and Lendenclub, have offered a ban on credits for borrowers to adapt to the interim's progressing challenge. To support the acquiring request, Faircent has propelled advance items, such as the 'counter lockdown advance' to assist borrowers in acknowledging along for simple reimbursement alternatives. It is additionally helping borrowers in green zones access fast and simple credits by labeling their postings as 'low effect COVID zone' on the stage.

The coronavirus pandemic has undoubtedly raised the danger of defaults by borrowers. Most specialists instruct the thumb rule regarding 80:20, which is loaning 80 percent to high-evaluated customers with sensible returns and 20 percent to low-appraised customers. It is prudent to expand the most extreme when loaning to bring down appraised customers.

"P2P loaning gives you a choice to look past values and obligation to acquire exceptional returns. Returns anyplace between 19-21 percent are normal thereby. Regardless of whether a few advances turn terrible, financial specialists can look at present win 12-14 percent on their capital," says Prakarsh Gagdani, CEO, 5paisa.com.

Saumya Shah, Founder of Tarrakki, a riches the board stage, says the interest from high total assets people to investigate P2P loaning as a venture has expanded post the lockdown since we are declining financing cost condition. "Even though profits may decrease throughout the following, not many months for moneylenders, P2P loaning will see more requests, and P2P players will pick up a piece of the overall industry."

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Therefore, whenever oversaw well, P2P loaning could be a worthy alternative to move assets stuck in low-yield ventures to win more significant returns.

CONCLUSION

With the advancement in information and technology reshapes the way we interact and transact. The P2P loaning gained popularity from the possibility that by expelling financial institutions as brokers and substituting them with online platforms, both acquisition and loaning were more desirable. In India, operations of P2P platforms are now under RBI's gamut and mandatory to obtain registration. The directions implemented by RBI should play a prominent part in recognizing this industry. There are 21 registered P2P firms in India on July 16, 2020.

The COVID-19 crisis has forced traditional banking and financial institutions to cease or severely curtail the lending process. This horrible emergency has made an open door for complete digitization of one of the most established budgetary foundations – loaning. P2P loaning stages show premonition and a sharp comprehension of the circumstance and consolidate it with imaginative innovation use will rise as clear champs.

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ISBN: 978-81-947738-1-8

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