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An Overview of the Peer to Peer Lending Industry of India

Pooja Khatri
(Assistant Professor, Swami Shraddhanand College, University of Delhi)

ABSTRACT*: Peer-to-Peer lending is a product of financial innovation which in the form of a virtual marketplace helpsto connect verified borrowers looking for unsecured personal and business loans with investors looking to earn higher returns from lending funds.The stringent regulations of the traditional banking system regarding capital, collateral, high bank rates, complicated formalities, and lengthy documentations are bypassed by the online P2P lending platforms. Such platforms have a large presence in UK, USA, Germany, Singapore, China, and Hong Kong but came to India recently in 2012 and related regulations were notified by RBI in 2017. It provides a number of benefits to the lenders of surplus money in the form of diversified high returns. The unbanked and under-banked sections of the society like MSME units, people with poor credit history also find easy access to quick and flexible funds. Although the default risk lies with the lenders only because the platforms just assess the creditworthiness of the potential borrowers leaving the final decision to lend or not on the lenders. It is expected to become a $ 5 billion worth industry by 2023 and is believed to revolutionize the way financial transactions are performed. This exploratory paper based on secondary data attempts to bring about various reasons for the exponential growth of online P2P lending in current times, the risk factors for various parties and the ways in which it is different from the traditional banking system. The paper also explains in detail the P2P lending process, conceptually analyze the different aspects of regulations notified for the P2P platforms in India and explores the Indian scenario with special reference to India's prominent P2P lending platform named faircent.com. The study aims to guide investors, lenders, and regulators.*

KEYWORDS: *P2P, peer-to-peer lending, NBFC, traditional banking, RBI.*

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I. INTRODUCTION

Peer-to-peer lending is also known by names like P2P lending, social investing, market place lending, crowd lending, and direct consumer lending. It is a debt based most common form of crowdfunding activity on the basis of the amount of capital raised. It has a huge presence in the UK, USA, and China. The industry began in the UK in 2005 with the inception of Zopa, a personal finance peer-to-peer lending company. UK is now a leading nation in crowdfunding activities especially the P2P lending segment. It is understood as a web-based financial intermediation activity. This relatively new financial innovation connects verified borrowers looking for unsecured personal and business loans with investors looking to earn higher returns from lending funds. No prior relationships are needed between the lenders and the borrowers. The P2P lending platform acts as the peer-to-peer intermediary that provides a platform to pair borrowers with individual lenders. Such platforms run as for-profit organizations. The platform assesses the credit risk of individuals and businesses filing loan applications with them on the basis of variables like borrower's income, debt to income ratio and loan payment performance. A credit rating is determined and an interest rate is decided accordingly. Lenders get to see borrower's profile on the online platform to determine whether they would want to lend money. The monthly loan repayments are also directed to the lenders through the P2P intermediary. However, the platforms take no responsibility of loan repayment and do not act like the traditional banking intermediaries. Both lenders and borrowers find themselves in a better position than under the traditional banking system although the risk lies with the lenders only and not with the platforms connecting them. Regulations regarding this sector vary across nations. In India, RBI decided to treat P2P lending service providers as NBFCs (Non-Banking Financial Companies) and issued notifications to regulate the P2P lending platforms in 2017 in order to provide protection to the interests of both borrowers and lenders. Some prominent registered P2P lending platforms in India are i2i funding, faircent, finzy, i-lend, LenDen club, and PaisaDukan. The P2P online lending industry should be credited to bring close the financial system and the real economy. The paper here attempts to explore different aspects of P2P lending in India. Also, data from faircent.com which is the first registered P2P platform in India is used to analyze some of the trends of online lending.

Objectives

- To understand the reasons behind the growth of peer-to-peer lending.
- To understand the P2P lending process.
- To explore the differences between traditional banking system and online P2P lending system.
- To explore different aspects of P2P lending in India with a special reference to data available on India's prominent P2P lending platform named Faircent.com.
- To understand the risk factors of P2P lending to various parties.

Organization Of Paper

This paper is structured in various sections. Section 1 introduces the concept of peer-to-peer lending, and the objectives of the present study. Section 2 provides a review of recent literature about various areas of P2P lending as a form of fintech innovation. Section 3 describes the scope and methodology of the present study. Section 4 presents the subject matter of the study. Finally, it has been concluded by summarizing the study and discussing the outlook for further studies.

II. REVIEW OF LITERATURE

- **Michael Klafft (2008)** analyzes the loan profitability data of a US P2P lending platform Prosper.com to explore whether lenders are able to obtain an attractive return on their investments despite potentially significant information asymmetries. The study analyzes if borrower's information as presented on the platform reduces information asymmetries. The study shows that P2P lending did not prove to be much profitable for the private lenders as there were large number of loan defaults. The study suggests some simple rules for the lenders while choosing potential borrowers to make their investments a profitable venture.
- **Sebastian Christoph Moenninghoff, et al. (2012)** highlights the need of risk management into peer-to-peer finance because of its potential macroeconomic implications for the stability of the entire financial system and transmission of monetary policy objectives. There is a need of funded or unfunded risk management mechanism. The increasing share of institutional funds on P2P lending platforms make the introduction of funded risk management mechanism a necessity. The study describes innovation and increased internet penetration as the major drivers for the emergence and growth of peer-to-peer finance. The future role of P2P finance may be influenced by upcoming innovations regarding asset transformation, monitoring and information processing, liquidity and payment services, and risk management. It establishes that risk management by individuals and regulators will largely determine the future of peer-to-peer financial transactions.
- **Gordon Burtch, et al. (2013)** analyzes patterns of country-to-country lending volumes of individual transactions from 2005 to 2010 on Kiva.org which is a global online crowdfunding platform providing P2P lending services. The study attempts to understand the role of cultural and geographic distances on the selection of transaction partner by individual lenders. It establishes that lenders prefer borrowers of similar culture and from geographical proximate areas. Also, geographic and cultural distances are concluded to be a substitute for the lenders. Role of third-party institutional trust mechanism is important to mitigate the negative effects of cultural differences. The study also present results with important implications for the participants on P2P lending platforms for instituting other model specifications
- **Traci L. Mach (2014)** studies the patterns of peer-to-peer borrowing by small businesses on Lending club which is one of the largest P2P lending companies in the USA. Logistic regression over data from individual loans and applicationsestablishes that loans for small businesses were more likely to be funded than the ones designated for other purposes. Small businesses were charged a percentage point interest rate premium over other non-business loans. Also, small business loans were more likely to become delinquent than other loans. The policymakers are suggested to closely observe levels and terms of lending to small business owners as they are now increasingly opting for P2P platforms due to easy procedures as compared to the traditional banks.
- **Kevin Thomas Davis, et al. (2016)** highlights the P2P lending model of the Australian economy along with the associated for both lenders and borrowers. The paper suggests a need for renewed approach to market regulation which should be more consistent with increasing institutional arrangements. The approach used by P2P operators is also claimed to be similar to that of the stock market order book. Lenders on P2P platforms face problems because of being ill-informed, lack of financial advice related to risk, investment illiquidity risk, and risk of cessation of operations of the P2P operator itself.
- **Pushpa BV, et al. (2016)** explores the reasons for the rise of P2P lending culture in the Indian market. The study establishes that this financial innovation aims to benefit the lenders, borrowers and other players who provide ancillary services for the disintermediation of credit. The study analyzes the data collected from Faircent.com which is a leading P2P platform in India to conclude that this form of lending has huge scope

in shaping the financial future of the nation. Also, the author puts forward her concern over the regulations that may make the functioning of P2P lending sector more restrictive just like the formal bank credit.

- **Rainer Lenz (2016)** analyzes the opportunities and risks of P2Plending platforms for borrowers and lenders. The study also presents the differences between a number of national regulatory approaches. It establishes that P2P lending platforms challenge existing regulators as modifications of existing finance and banking laws is inadequate for proper regulation of P2P platforms. A dedicated single European regulatory approach different from the one adopted for banking is required. It establishes that regulations for web-based intermediation of financial services must focus on consumer and data protection. Along with regulators, banks and central banks are also needed to reorganize themselves. Banks need to become more like other web-based financial intermediaries. Central banks are needed to maintain credit creation even via the P2P platforms in line with the objectives of monetary objectives. P2P model is praised for its capacity to restore close connections between the financial world and the real economy.
- **Atsushi Samitsu (2017)** establishes that P2P lending is one prominent example of fintech business. The study compares the P2P lending structure by using traditional bank lending as a reference point on the basis of a number of factors. It establishes that legal arrangements in P2P lending vary across countries and so does the degree of investor protection and proposes some schemes for strengthening investor protection in the Japanese financial environment. P2P lending mechanism distributes social surplus among borrowers and lenders. Borrowers get a relatively lower rate of interest and speedy access. Lenders get access to a higher yield than possible through deposit rates. There is no inherent systematic risk involved in the balance sheets of P2P platforms but factors like rising interconnectedness due to the involvement of institutional lenders and securitization may lead to a possibility of systematic risks as well.
- **Caroline Stern, et al. (2017)** conducts a descriptive study to analyze the determinants of P2P lending in different areas of China. The study establishes that P2P lending is more extensive in areas with more mobile phone subscriptions, lower fixed assets investments and smaller size of the traditional banking sector. The pattern of growth of P2P platforms in China follows an inverted U-shaped curve. It also describes the financial system of China along with the emergence of many other fintech developments.
- **Caimei Lu, et al. (2018)** conducts an exploratory study to find factors unique to problematic P2P lending platforms and identify reasons for such factors. The sample for the study is 2259 platforms which are analyzed over fourteen different variables through the binary logistic model. Variables related to platform strength, profitability, risk control, liquidity, and transparency are taken for study. The results show that variables like type of company, platform background, type of project funded, operation time, interest rate, fund custody, the term of the loan, day-bid, transfer of creditors rights, automotive bidding and information disclosure are strongly related to the operating status of a P2P platform. It establishes that identification of risk factors over P2P platforms is important to reduce investor’s loss and promote healthy development.
- **OlenaHavrylchyk, et al. (2018)** analyzes data from Prosper and Lending Club which are two leading P2P lending platforms in the US consumer credit market. It attempts to explore drivers of the expansion of demand for P2P credit through three main hypotheses which are based upon global financial crisis, barriers to entry and learning costs. It establishes that P2P lending platforms to an extent have substituted banks which have cut their credit supply on account of the global financial crisis. It also states that expansion of P2P online lending is more in areas where there is lack of traditional banking branches. Also, P2P lending growth shows a positive relationship with the share of the educated and young population in an area. The study finds no robust impact of internet penetration and openness to innovation on the expansion of P2Plending. The study concludes by saying that P2P lending is not a niche market but could be a substitute for traditional bank’s lending.

III. SCOPE & METHODOLOGY

The present study looks into various aspects of the online peer-to-peer lending industry in Indian context. It is an exploratory study which attempts to throw light on the reasons behind the growth of peer-to-peer lending. It explains the P2P lending process in detail. The study highlights the

differences between traditional banking system and online P2P lending system. Data available on India’s prominent P2P lending platform named Faircent.com has been used to get insights of the industry in general. It also discusses the challenges of P2P lending for various parties. The study is based on secondary data. A number of industry journals, recent RBI notifications, online articles and newspaper articles have been used for analysis.

IV. ANALYSIS

Under the traditional brick and mortar form of financial intermediation, individuals in need of funds write loan applications to a bank. The bank assesses an applicant’s credit history and decides if the loan should be extended or not. The amount expended as the loan is from the funds that people with surplus money put in the banks as deposits. Thus, banks perform the credit intermediation function through maturity transformation. Under peer-to-peer lending, there is no institution to play the role of financial intermediary. There are individual investors who lend their own money to borrowers at an agreed interest rate. P2P lending platforms are virtual marketplaces which connect potential borrowers and lenders. The online platform provides a number of support services like identity verification of the loan applicants, assessment of applicant's financial details and pricing of loans through various credit-score based models, and monitor credit risk after loan extension. After this, verified borrowers are listed on the platform with their details for the borrowers to see. The final decision to lend or not is with the lenders only. Even banks, institutional investors and private equity firms are allowed to invest on the lending platform which is a growing concern because this can give rise to systematic risks in the financial system. As brought by Rainer Lenz (2016), the involvement of Institutional investors is against the very essential idea of P2P platform of disintermediation of consumer finance because these entities are themselves the intermediaries of the financial world. Such peer to peer loans are not secured by any government guarantee so lenders have to choose wisely while having options to lend a small amount to multiple borrowers for diversifying their investments. The borrowers even the ones with not very attractive credit history get easy and quick loans at interest rates that may be lower than what they would have got from the traditional banks. Even such financial needs are funded which might not have been approved by the standard intermediaries. The lenders get the opportunity to earn diversified interest income that generally exceeds the interest amount that can be earned through saving accounts and fixed deposits. Although the risk of default of such loans lies with the lenders only. Peer to peer lending is hugely favored option for alternate financing worldwide. In India, the industry took its first step in 2012 with the launch of P2P finance company i-lend. As per Fair assets Technologies Pvt Ltd. (owner of Indian P2P platform Faircent), the size of Indian P2Plending market was just Rs. 2 billion in September 2018. There are massive growth opportunities for P2P lending in the Indian economy both in terms of the number of online platforms and loan volumes. According to Inc42 Data Labs Report, P2P lending in India is expected to grow to be a $5 billion worth industry by 2023.

4.1 Reasons for the rise of P2P lending

The peer-to-peer lending industry is now widely accepted by borrowers in India because of the wide range of benefits it provides. This system breaks regional restrictions and aids to bypass the limitations of the traditional financial system like high bank rates, strict margins, complicated formalities, collateral requirements, and lengthy documentation. It enables lower cost for both lenders and borrowers. It allows faster loan approvals than under the traditional system because of use of improved big data analytics. The web-based platforms are also a convenient option as these are characterized by reduced bureaucracy and simple application process. Such online platforms use some non-conventional data points along with banking and credit history to assess creditworthiness so that borrowers with poor credit history who lack access to bank loans also get chances to borrow funds. Borrowers get chance to present their loan cases in detail which may be very unconventional and emergent in nature. The system allows disbursing credit to even those areas and entities like SMEs which are largely deprived of bank funding. For the investors, online P2P platforms allow transparency and openness to decide about their investments. The volatility in the stock market and comparatively lower earnings through bank savings make investors turn around to the platforms of marketplace lending. It provides stable investment options as compared to equity-based investments. A lender can expect returns based on the risk category of his investment which can vary from around 12% to 36% per annum. Lenders can diversify their investment options along with the assurance of fixed monthly income. There are low transaction costs because of elimination of the middlemen. Although the risks of loan default lie with the investors only butit can be reduced by diversified money lending among a number of borrowers. It allows making investments for short tenure also ranging from 5 months to around 24 months on most websites. The P2P online finance model also allows benefits of lower minimum investment options like Faircent.com allows investors to offer even Rs.750 per loan. The P2P lending platforms see a great scope of business because of the low cost of business as there is very little need for physical infrastructure if any. The online model also allows them to avoid tight regulations and supervisions as in case of traditional financial intermediation. Increase in mobile and internet penetration along with a rise in fintech innovations is also a contributing factor to the emergence as well as the growth of peer-to-peer finance. Some platforms also share a complete credit check process with lenders so that borrowers can be understood in a proper manner. After the introduction of RBI regulations in 2017, the overall environment has become safer and more trustworthy prompting more and more players to participate in the P2P finance process. As per a study conducted by research and advisory company, Transparency Market Research, the global peer-to-peer market is expected to be worth $898 billion by 2024, from just $26 billion in 2015. The market is expected to rise at a Compound Annual Growth Rate of 48.2% between 2016 and 2024.

4.2 The process of peer-to-peer lending.

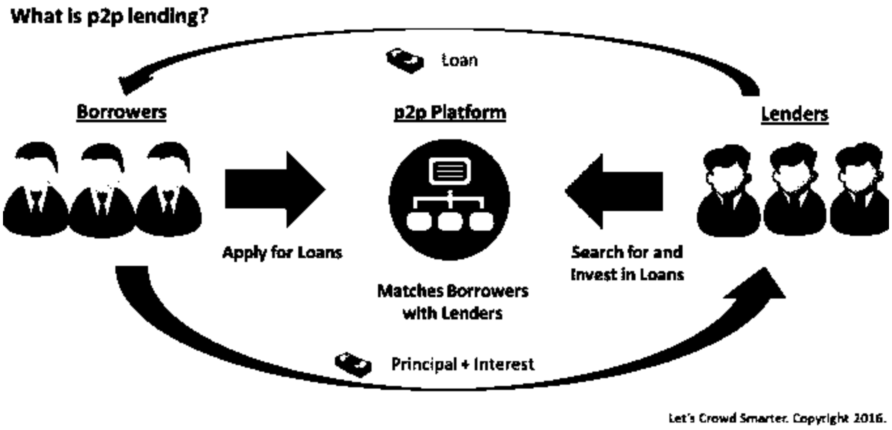

Figure1: peer-to-peer lending process
Source: http://letscrowdsmarter.com/beginners-guide-to-crowdlending-in-singapore/

Peer-to-peer lending platforms in the form of virtual market help potential lenders and borrowers find each other as depicted in figure 1 above. The process starts with simple registration by both the parties on the concerned platform. On most of the P2P platforms, the lenders simply register online, pay registration fees and upload necessary documents. After due verification, they need to fund their escrow accounts with investible funds. As per RBI guidelines, the exposure of a single lender across all P2P companies at any time is capped at Rs.10 lakhs. The borrowers also have to follow a registration process, pay the concerned fees and upload necessary documents. Basic KYC verification is based on documents like Pan or Aadhar which provide proofs of ID, age, signature, income, address, etc. After this starts the process of rigorous credit assessment of potential borrowers. Data used for this purpose is both traditional (like bank statements, pay slips, tax reports, etc.) and innovative like a borrower's online social behavior and facial recognition. For instance, at i2ifunding.com in India, a robust and automated credit evaluation process is followed which involves credit assessment based on more than hundred parameters using thousands of data inputs. The automated-in-house credit evaluation model developed at i2ifunding allows real-time integrated analysis based on personal and social information of the borrower, credit history through CIBIL score, employment, and educational information, and traditional financial information like monthly income, EMIs, bank account transactions, existing debts, expenditure pattern, etc. Broadly the automated custom-made systems based on algorithms, big data and AI attempt to give an indication of borrower's ability to pay and intend to pay. Such system is believed to be a better screening mechanism than the traditional banking Bureau score-based techniques. Borrowers are rated accordingly in different risk categories which range from very low risk to very high risk. Interest rates for loans are recommended based on the risk categories in which the loan proposal falls ranging from some 12% to 30% per annum. The loan applications along with relevant financial and personal details of the borrowers are listed on the P2Pplatforms for lenders to make informed choices. Lenders view the listed loans and send proposals to fund them at the given interest rates. A loan is generally funded by multiple investors who all get to earn the same rate of interest. Lenders attempt to diversify their investment into different risk categories. Lender's proposals are accepted on first come first serve purpose. Legally binding agreements are signed by the borrower and lender after a consensus is developed between them. Such agreements can be signed digitally or physically. Investors transfer the lent money to the nodal escrow account of the borrower. Escrow account refers to the non-interest-bearing accounts operated by trustee promoted by the bank maintaining such accounts. P2P platforms also facilitate repayments. The borrower is supposed to repay the loan amount through EMIs via his escrow account from which the lender receives a monthly payment. A complete repayment schedule is prepared by the platform and any delay or default makes the borrower liable to a penalty. Pre-payments can be made without any extra charges. The lender gets option either to reinvest the monthly payments or to take the money out. All the money transfers take place online and no cash transfers are allowed as per the RBI guidelines. Thus, P2P lending platforms help to legalize the transactions through formal agreements between the lenders and borrowers, facilitate money transfer, collection and recovery. At no point in time, do they guarantee any return, take loan decisions or guarantee repayments. The role of such platforms is to facilitate decision making of lenders and borrowers by providing them with relevant information.

4.3 Comparing traditional bank loans and P2P loans

P2P lending differs from traditional bank lending on several parameters as explained in table I below.

Table I: Differences between traditional bank loans and P2P loans.

Basis of Difference	**Traditional bank loans**	**P2P loans**
Borrowing costs	Higher operating costs because banks incur a range of costs from lengthy paperwork to maintaining of bank's infrastructure. These get transferred to borrowers in the form of high-interest rates.	Lower operating costs because of the absence of any significant physical infrastructure and the absence of intermediary functions. These get transferred as a better rate of interest to borrowers.
The approach towards loan purpose	Banks follow a conservative approach and loan applicants need to fit some standardized requirements and categories.	A more holistic approach is followed where diverse and unique requirements of borrowers get funded.
Process	Cumbersome and time-consuming process.	The online process is much quicker.
Model type followed	One-to-many model is followed where one bank extends depositor's money to many people.	Many-to-many model is followed where a borrower can fund his needs from a number of lenders and a lender can also diversify his investments among many borrowers.
Transparency	Depositors and borrowers of funds have no information about each other.	Investors and lenders are in complete knowledge of each other.
Assessment of credit-worthiness	Use of traditional, codified, and explicit financial and credit references by the banks.	Big data analytics tools are used to examine a large set of economic, personal as well as social factors.
The rate of return for the supplier of funds	A lower rate of return for investors in bank instruments.	Higher returns based on the risk class of investment made.
The flexibility of repayment	Less flexibility.	More flexible as most platforms allow to make overpayments or pre-payments.
Loan decisions	Made by the bank.	Made by the lenders of funds themselves.
Monitor of borrowers after lending	By the bank.	By the P2P platform.
Default risk	Borne by the bank.	Borne by the lenders themselves.
Centralization of risk	Centralized risk on the bank.	Decentralized risk on a number of lenders.
Earnings	Banks earn in the form of margin between deposit and loan rates.	Platform earns in the form of transaction fees charged from both lenders and borrowers.
Collateral requirements	Both secured and unsecured loan options exist but generally collateral is a must.	Lack of collateral does not hinder the loan process.

Source: Compiled by self.

4.4 Regulations for Indian online P2P lending industry.

P2P lending platforms have a significantly large presence in the economies of the UK, USA, Germany, Singapore, Hong Kong, and China. Although in the last few years, China has experienced a shutdown of many P2P lending platforms. As per a Bloomberg report, 4500 platforms closed operations between 2013 and 2018. This crisis is majorly a result of lack of proper regulatory framework. In an attempt to curb many wrong practices, China came up with stringent regulations for the sector which caused a panic among many investors as well as P2P lending platforms. India should learn lessons from China's experience as Indian P2P lending industry is also growing rapidly. There were no regulations until 2017 when RBI came out with guidelines for the P2P lending platforms and also notified that such platforms be registered as NBFCs (Non-Banking Financial Companies). The regulations have been largely taken up very positively and are expected to bring P2P lending platforms into the mainstream financial market as it has been observed in the case of many countries including North America where the market share of P2P lending market rose from 39% to 43% between 2014 and 2016 when the government began regulating the industry. Some of the key guidelines released by RBI are analyzed here.

4.4.1 Registration process:

All prospective P2Ps are required to get themselves registered as NBFC by submitting an application to the Department of Non-Banking Regulation, Mumbai. The then existing NBFC-P2Ps were given three months from the date of issuance of directions to comply with the registration process. The P2P platforms thus obtain the Certificate of Registration (CoR) from RBI to commence and carry P2P business. The entity applying for registration shall also possess necessary technological and managerial resources along with adequate capital structure. It should submit a plan for a robust and secure IT system along with a viable business plan. Such CoR can also be canceled by the RBI on the failure of NBFC-P2P to comply with required conditions.

4.4.2 The requirement of a certain amount of Net Owned fund:

The P2P lending platforms seeking registration should have net owned funds of at least Rs.20 million or such higher as may be specified. This is to ensure long-run protection of the interests of the lenders and borrowers and increase the industry's credibility. It also ensures adequate investment in technology, customer support, credit assessment, and secure IT systems.

4.4.3 The scope of activities:

An NBFC-P2P is allowed to act as an intermediary to provide an online marketplace to participants of P2P lending, take due diligence, undertake credit assessment and risk profiling, take prior consent of borrowers to access their credit information, undertake documentation, and provide assistance in disbursement and repayment of loans. The NBFC-P2Ps are not allowed to raise deposits, lend on their own, provide credit enhancement or guarantee, hold funds received on their own balance sheets, permit international flow of funds and secure data related to activities or participants on hardware located outside India.

4.4.4 Leverage ratio:

The NBFC-P2Ps are required to maintain a leverage ratio of 2:1. It is the ratio of debt against owned capital and not against the lending made on the platform to ensure higher financial stability.

4.4.5 The cap on lending and borrowing:

RBI requires that the aggregate exposure of a lender to all borrowers across all P2Ps should not exceed Rs. 10 lakhs at any point in time. The aggregate loans taken by a borrower across all P2Ps should also not exceed Rs. 10 lakhs at any time. Not just this but the exposure of a single lender to the same borrower across all P2Ps is also capped at Rs. 50,000. All such loans should have a maturity of maximum 36 months. This restriction is believed to be restricting the freedom of lenders to diversify investments across multiple borrowers. The limit is too low to effectively diversify investments and maximize returns. Also, the borrower's capacity to raise funds is restricted and thus the entire spirit of financial inclusion is threatened.

4.4.6 Operational guidelines:

NBFC-P2Ps are required to have board-approved policies to set eligibility criteria for participants, determine the price of services and set rules for matching lenders and borrowers. No loan should be disbursed unless the lender approves the recipient of the loan and both parties have signed the legal contract. The board should approve a business continuity plan for safekeeping of information and documents for all tenure in case of platform closure.

4.4.7 Escrow accounts:

RBI requires all fund transfers on P2P lending platforms through escrow accounts mechanism operated by a trustee which shall be promoted by the bank maintaining such accounts. At least two escrow accounts are mandatory; one for funds received from lenders and pending disbursal, and another one for collections from the borrower. All fund transfersare to be through bank accounts and no cash transactions are allowed at all. It has made the financial transactions faster, smoother and much more secure.

4.4.8 Data submission to Credit Information Companies (CICs):

All NBFC P2Ps are required to become a member of all CICs and submit data to them including any historical data. NBFC-P2Ps are also required to keep credit information maintained by it and update it regularly on monthly basis or at any such interval as agreed between NBFC-P2P and CICs. This is expected to reduce default rates and enhance the credibility of the system.

4.4.9 Transparency and disclosure requirements:

An NBFC-P2P is entitled to disclose details about the borrowers, any terms and conditions regarding fees, taxes or return to the lenders. The borrowers should also be informed about the lenders, proposed amount, the interest rate offered but not the personal identity. The platforms are required to put on its website an overview of credit assessment methodology, facilities for data usage and protection, grievance redressal mechanism, portfolio performance, and broad business model.

4.4.10 Grievance Redressal:

NBFC-P2Ps have to put in place a board-approved grievance redressal policy to address participants grievances. Complaints should be handled and disposed of within one month of the date of receipt in such manner as specified in its policy.

4.4.11 IT framework and data security:

NBFC-P2P's business model should be primarily IT-driven and such IT capabilities should be scaled up according to the size of business growth. There should be adequate safeguards to provide protection against unauthorized access, alteration, destruction, and dissemination of records.

4.4.12 Supervision and exemptions:

RBI can cause inspection of any NBFC-P2P at any time by its officers or employees. RBI can also exempt any NBFC-P2P from any of the provisions of the regulations.

The RBI regulations have brought more legitimacy to the system along with the promotion of a structure and levelingthe field for all financial institutions. The P2P platforms are expected to become more transparent, credible and stable. The regulations aid to establish P2P lending model as a more lucrative asset class like other investment options such as MFs, SIPs, and stocks. Faircent.com has already claimed the benefits of such regulations as it observes that after registration, it drew around 8,000 new lenders each month as compared to just 1,500 prior to the introduction of RBI guidelines. Similarly, Lenden club also claims 7 to 8 times more lenders post RBI regulations. Over time, it is expected that P2P lending platforms will contribute heavily to financial inclusion by facilitating easier credit for the country's unbanked or underbanked sectors.

4.5 Indian scenario with special reference to faircent.com.

As per Research and Markets report, P2P lending market is expected to grow at a CAGR of 51.5% from 2016 to 2022 and become worth US $ 460 billion in 2022 from just US$ 26 billion in 2015. In India, P2P lending is believed to bring about more inclusive financial solutions to different sections of the society because of being completely digital, based on custom assessment, having flexible lending amounts and lock-in periods and being effectively regulated by RBI. This sector which was born in India in 2012 with the launch of i-lend as its first P2P finance company has exponential growth opportunities because of the various benefits it provides over the traditional banking system. As per financial express, the overall P2P lending industry was some Rs. 5-6 crore in January 2018 compared to Rs. 20-25 crore in December 2018. The top few players are expected to experience a growth rate of some 100 to 400%. The industry is also becoming increasingly popular amongst millennials who believe in investing for present circumstances and are highly inclined towards digital transactions. The sector has become a favorable option for financing MSEs, festive loans, medical emergencies, education, etc. MSMEs suffer financial exclusion mainly because of lack of comprehensive credit score, unplanned cash flows and lack of negotiating power with suppliers. Also, the formal banking system tends to support only the aspirational MSMEs with good bureau records and loan needs of above 15 lakhs for minimum 3 years. Many small units remain unfinanced and thus P2P lending sector which facilitates loans of an amount ranging from Rs. 10,000 to Rs. 10 lakhs for even a day to a maximum of 3 years are becoming increasingly popular amongst the MSMEs. Generally, all platforms experience a surge in loans enquires during festival season. The flexibility in the amount borrowed and repayment options makes this platform very popular for such loan proposals. It also facilitates instant financing for medical emergencies in a very hassle-free, seamless and transparent manner. This section analyzes data with reference to faircent.com. It is the largest P2P lending platform in India and also the first platform to receive the NBFC-P2P certification from RBI.

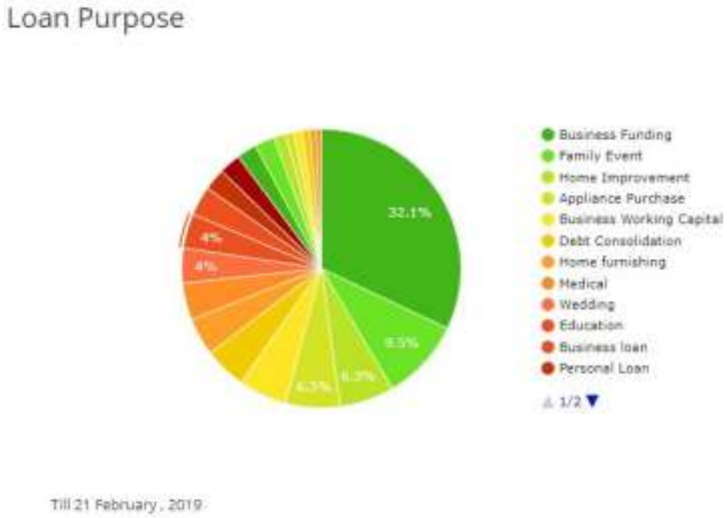

Figure 2: A breakdown of loan purpose on faircent.com.

Source: www.faircent.com

The lenders on this platform were committed to lend more than Rs 853 million for returns up to 25% and borrowers to borrow more than Rs 565 million at interest rates as low as 12% as on 21st February 2019. A breakdown of loan purposes in figure 2 shows that around 32% of loans are taken for business funding and the second most common purpose being family events. Home improvements and appliance purchase are also common reasons to borrow. Along with these, loans are also taken to finance business working capital, debt consolidation, medical, wedding, education, car purchase, land purchase, travel, etc. It shows that some unconventional needs are also being financed through P2P platforms.

Table II: Loan amount raised, loan tenure and average ROI earned for loans of different risk classes.

Risk category	Loan amount proposed (in INR lakhs)	Average loan tenure (months)	Average ROI earned
Minimal risk	30.883	31.01	12.21%
Low risk	342	25.52	16.28%
Medium risk	1930	23.84	19.50%
High risk	2122	24.20	23.09%
Very high risk	432	24.20	27.07%

Source: Compiled by self and data taken from Faircent.com.

The data related to loan amount proposed, average loan tenure and average ROI earned for different risk categories as on 21st February 2019 in table IIshows that maximum amount proposed for loans fall in the 'high-risk category' providing an average ROI of 23.09% p.a. Loans in'very high-risk category' provide the highest average ROI but are not very famous among the lenders.

Table III: Loss rates and net returns for different risk classes on faircent.com.

Risk category	Loss rate	Net returns
Minimal risk	0%	12.9%
Low risk	0%	17.2%
Medium risk	0.5%	19.9%
High risk	5%	18.7%
Very high risk	10 %	18.6%

Source: Compiled by self and data taken from faircent.com.

Data related to loss rate and net returns for different categories in table III shows that loss rate is around 10% in the 'very high-risk category'. The loss rate is lower in the 'high-risk category' and completely nil in 'minimal risk and low-risk buckets'. The loss rate is defined as the percentage of borrowers who fail to pay EMIs for more than 6 months. Although net returns defined as percentage interest income from investments minus any potential loss from defaults for all borrowers in a risk portfolio is maximum in case of medium risk category associated with 0.5% of loss rate.

Faircent.com truly takes forward the aim of financial inclusion to different sections of the economy. Data shows that around 17% of disbursed borrowers are from tier 3 cities which largely remain underbanked under the traditional systems; about 35% of borrowers are new to credit which are here assessed on other dynamic factors, and around 17% borrowers are females who generally get less access to formal credit despite low default rates. Small scale industries, disabled people as well as senior citizens have funded their credit needs via faircent.com. There are different investment products being promoted focusing primarily to lend funds to salaries millennials, young business setups with less than 5 years of stability; borrowers from non-metro cities, matured business and aspiring women. P2P lending is increasingly being recognized as credible financing as well as an investment option and will soon revolutionize the way lending and borrowing activities are conducted. OlenaHavrylchyk (2018) establishes that P2P lending is not a niche market but could be a substitute to traditional bank's lending in near future.

4.6 Risks in the online P2P lending industry:

Despite so many advantages and wide scope of P2P lending platforms, there are some risk factors that should be taken care of by the lenders, borrowers, and platform operators. The challenges of online P2P lending sector are mentioned here:

- The industry is still maturing. It is yet to see how different regulations affect online business.
- It is expensive to set up a P2P lending platform because significant investment in the latest and secure Information Technology environment is a must.
- The platforms need to attract a large number of users to become profitable or break-even.
- Quality of credit risk assessment may get affected because of informational asymmetries.
- Borrowers experience uncertainty of their full financial requirements getting funded at favorable rate of interests.
- Gordon Burtch (2013) highlights that online lenders generally prefer borrowers from similar cultures and geographical proximity. This restricts the spirit of financial inclusion.
- The Rs. 10 lakhs cap on lending restricts lender's flexibility to diversify investments and earn higher expected returns.
- There are many new startups providing online P2P lending facilities so lenders and borrowers should check that such platforms should be registered as NBFC-P2Ps before beginning any activity on them.
- Lenders should not initially invest heavily by getting lured with the chances of high returns. They should start with low investments and expect returns based on the risk class of investment made.
- An investor should do proper research about the potential borrowers before extending funds as the online platforms neither assure any repayments nor take the default risks.
- Lenders should effectively diversify their investments among multiple borrowers and over multiple months based on average returns and risk profiles of borrowers to mitigate risks.
- Lenders should check the ratio of defaulters on the platform before investing funds.
- The exponential growth of some multinational technology firms like google, amazon and facebook and their entry into financial services business bring tough competition to P2P lending platforms because their large firms already have huge retail customer base.
- There are no standards on how transparent the credit assessment process should be.
- High capabilities for operations, technology, and credit risk management are must for online P2P lending platforms which is a costly affair. There are also a large number of operational complexities in terms of fund transfers and keeping track of loans disbursed.
- Data privacy laws are very complex and not yet clearly defined.
- The platforms may be used for money-laundering if KVC checks are not efficiently compiled by.
- There is a lack of strong cybersecurity controls that can expose the platforms and money held to hackers.

Such limitations and challenges associated with online P2P lending industry bring about how the industry is not a full-proof solution to all atrocities of the traditional financial industry. Despite such challenges, the online P2P lending industry is expected to grow in leaps and bounds to transform the way financial industry functions. Further research can be done to empirically analyze the effect of online P2P credit and investment in the field of financial inclusion. A primary study can be conducted to analyze what risks do the lenders and borrowers perceive on the platforms and what possible improvements would they like to see in the near future.

V. CONCLUSION

Peer to peer lending is understood as an online activity where P2P platforms act as the marketplace to connect investors and borrowers of funds electronically. There is no need of any prior relationship between both the parties. A simple registration on the platform by lenders and borrowers is followed by a rigorous credit assessment process. The platform analyzes the creditworthiness and then classify loan requests into different risk categories leaving the decision to extend or not expend funds on the lenders only. The present exploratory study has analyzed the reasons for the exponential growth of P2P lending, the challenges and risk factors for different parties. It has also analyzed the differences between traditional loans and P2P loans. The process of P2P lending has been explained in detail. The paper based on data presented on faircent.com concludes that P2P lending has high scope for growth in the current financial environment where a large section of the society like MSMEs, women, senior citizens, etc. remain underbanked due to rigid regulations of the traditional banking industry. RBI introduced guidelines for this sector in 2017 to make the industry more stable and legitimate. Although the online lending industry is expected to grow at CAGR of 51.5% from 2016 to 2022 according to Research and Markets reports, still there are many challenges for lenders, borrowers and platform operators which should be taken care of.

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