P2P LENDING: THE CHALLENGING LANDSCAPE OF NBFCs

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Abstract: Non-banking finance companies (NBFCs) form an integral part of the Indian financial system. They play an important role in nation building and financial inclusion by complementing the banking sector in reaching out credit to the unbanked segments of society, especially to the micro, small and medium enterprises (MSMEs), which form the cradle of entrepreneurship and innovation. In the Indian financial arena, Non-Banking Finance Companies (NBFCs) are also known as Shadow Banks.

The NBFC segment has evolved considerably over a period of time in terms of operations, heterogeneity, asset quality, profitability and regulatory architecture. The Reserve Bank has been working on consolidating the various categories of NBFCs. At present, there are 12 categories of NBFCs. The latest addition is - NBFC – Peer to Peer Lending Platform (NBFC-P2P).

P2P Lending can be defined as the use of an online platform that matches lenders with borrowers in order to provide unsecured loans. The borrower can either be an individual or a legal person requiring a loan. The interest rate may be set by the platform or by mutual agreement between the borrower and the lender. Fees are paid to the platform by both the lender as well as the borrower. The platform provides the service of collecting loan repayments and doing preliminary assessment on the borrower's creditworthiness. The fees go towards the cost of these services as well as the general business costs. The platforms do the credit scoring and make a profit from arrangement fees and not from the spread between lending and deposit rates as is the case with normal financial intermediation.

Key words: Non-Banking Financial Companies (NBFCs), Peer-Peer (P2P) Lending Model, Online Platform.

Introduction

The NBFC sector in India has grown significantly during the last few years and has become an important segment in the financial sector contributing to almost 10 per cent of the total assets of the financial sector. The segment has witnessed considerable growth in the last few years and is now being recognized as complementary to the banking sector due to implementation of innovative marketing strategies, introduction of tailor-made products, customer-oriented services, and attractive rates of return on deposits and simplified procedures, etc. The financial sector is not immune from the advent of online industry and its potential impact. For this reason, it is attracting attention of analysts, investors, customers, businesses and regulators in a major way. **Peer-to-Peer (P2P)** lending is one such business model that has gathered momentum globally and is taking roots in India also.

With the upcoming popularity of online communities in the past decade a new way of loan origination has entered the credit market: online peer-to-peer (P2P) lending. It transfers the old idea of personal credits into the World Wide Web. In this kind of lending model the mediation of financial institutions is not required. The decision process of loan origination is given into the hand of private lenders and borrowers.

Objectives of the Study

The purpose of this study is to analyze the importance of fast growing trend of NBFCs in financial sector with special reference to new category of NBFC- P2P Lending.

NBFC – Peer to Peer Lending (NBFC-P2P)

P2P lending is a type of debt financing that allows individuals as well as businesses to borrow money online, without having to rely on an official financial institution as an intermediary. Just like an online marketplace brings buyers and sellers on a single platform to transact, P2P lending marketplaces bring borrowers and lenders together.

RBI defines the business of a peer to peer lending platform as ***"the business of providing under a contract, the service of loan facilitation, via online medium or otherwise, to the participants who have entered into an arrangement with that platform to lend on it or to avail of loan facilitation services provided by it".***

P2P (Peer to Peer) lending and borrowing is like a digital marketplace for loans. This concept of P2P lending is centered around lenders getting higher interest rates by lending their money instead of putting it in savings and borrowers getting lower interest rates as opposed to getting a loan from a bank. Traditionally, anyone who wanted to take a loan, individuals or businesses, had to apply through a bank. The bank in turn would run extensive financial background checks to determine the applicants' credit score and loan history to determine if they qualified for a loan and, determine the interest rate that was charged on the loan.

P2P lending works best for early stage startups and entrepreneurs who need to kick-start their business. These businesses usually seek seed or venture funding to acquire the cash to get started. As an early stage of startup people may not be ready or in need of that much money to liquidate their equity. Getting a loan from a bank demands higher interest rate and collateral. Entrepreneurs can borrow smaller amounts of money from individuals with ease through this lending facility.

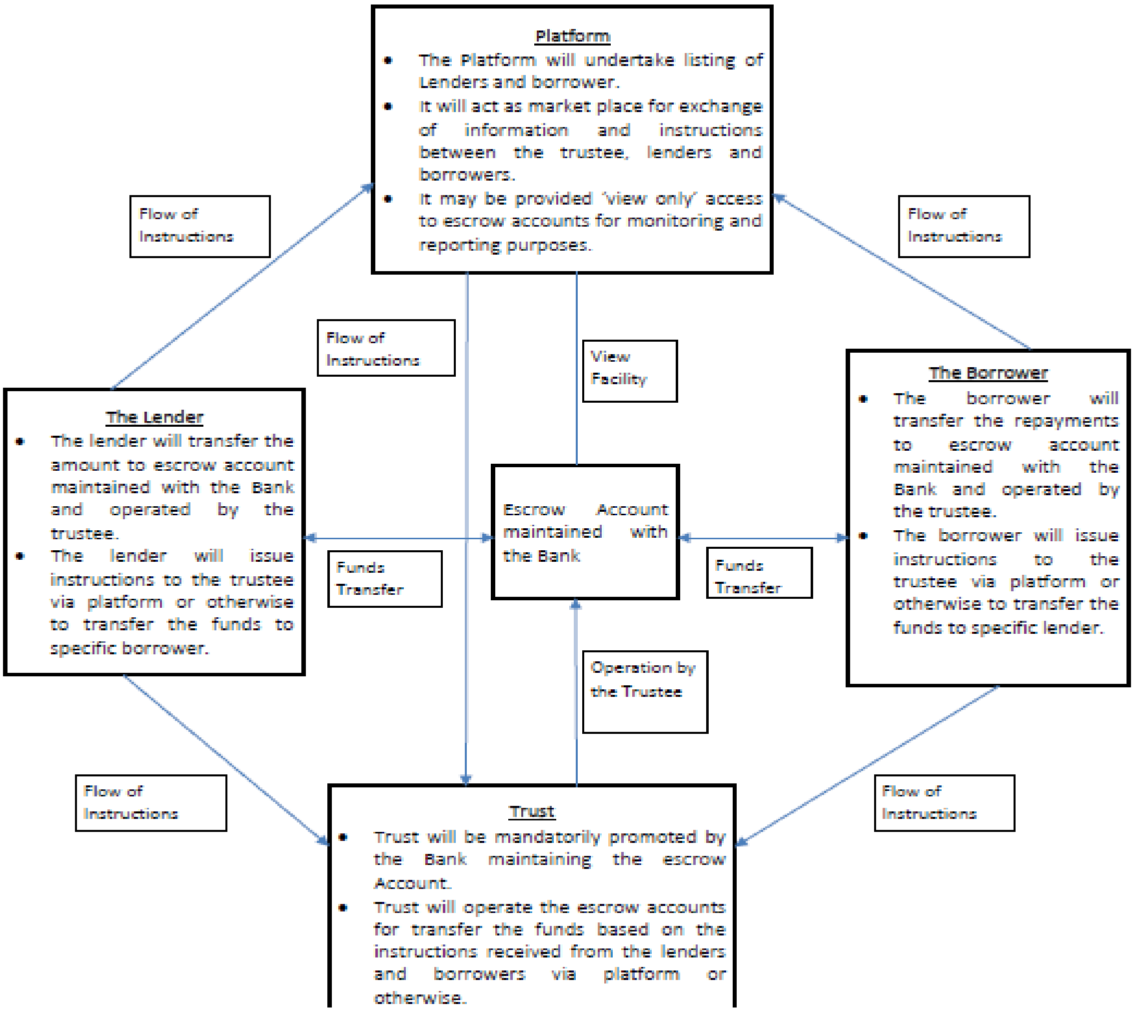
With peer-to-peer lending, borrowers take loans from individual investors who are willing to lend their own money for an agreed interest rate. Fees are paid to the platform by both the lender as well as the borrower. The borrowers pay an origination fee (either a flat rate fee or as a percentage of the loan amount raised) according to their risk category. The lenders, depending on the terms of the platform, have to pay an administration fee and an additional fee if they choose to use any additional service (e.g. legal advice etc.), which the platform may provide. The profile of a borrower is usually displayed on a P2P lending platform, where investors can view borrowers' profiles and decide if they want to lend money to them. A borrower might receive the full loan amount or only a portion of what he asked for from an investor. In the case of the latter, the remaining portion of the loan may be funded by one or more investors in the peer lending marketplace.

Operational Business Model of P2P Lending in India

P2P lending platforms are largely tech companies registered under the Companies Act and acting as an aggregator for lenders and borrowers. Once the borrowers and lenders register themselves on the website, due diligence is carried out by the platform and those found acceptable are allowed to participate in lending/borrowing activity. The companies often follow a reverse auction model in which the lenders bid for a borrower's loan proposal and the borrower has the freedom to either accept or reject the offer. Some platforms provide several additional services like credit assessment, recovery etc. In most cases, the platform moderates the interaction between the borrower and the lender. The documentation for the lending and borrowing arrangement is facilitated by the *P2P platform*. The lender transfers money from his/her bank account to borrower's bank account. The platform facilitates collection of post-dated cheques from the borrower in the name of the lender as a proxy for repayment of the loan. The P2P forum, in general, also helps in the recovery process and as part of this, follows up for repayments and if need be, employs recovery agents too.

In this elementary model, the lending is primarily from one individual to another. The regulatory concerns in such cases would relate to KYC and recovery practices. Since all payments are through bank accounts, the KYC exercise can be deemed to have been carried out by the banks concerned. Though these platforms claim to follow soft recovery practices, the possibility of use of coercive methods cannot be ruled out.

Funds Transfer Mechanism



RBI guidelines for NBFC-P2P Lending

Do's	**Don'ts**
Provide online platform to participants involved in P2P lending	Raise deposits
Due Diligence of participants	Lend on its own
Credit risk assessment and risk profiling of borrowers	Provide credit enhancement or credit guarantee
Documentation of loan agreements	Hold funds for lending or receive funds from borrowers
Assistance in disbursements and repayments of loan amount	Cross sell products

Services for recovery of loans	Cash transactions
Submission of data to credit information companies.	

Prudential Norms

1. NBFC-P2P shall maintain a Leverage Ratio not exceeding 2.
2. The aggregate exposure of a lender to all borrowers at any point of time, across all P2Ps shall be subject to a cap of 10, 00,000.
3. The aggregate loans taken by a borrower at any point of time, across all P2Ps, shall be subject to a cap of 10, 00,000.
4. The exposure of a single lender to the same borrower, across all P2Ps, shall not exceed 50,000.
5. The maturity of the loans shall not exceed 36 months.
6. P2Ps shall obtain a certificate from the borrower or lender, as applicable, that the limits prescribed above are being adhered to.

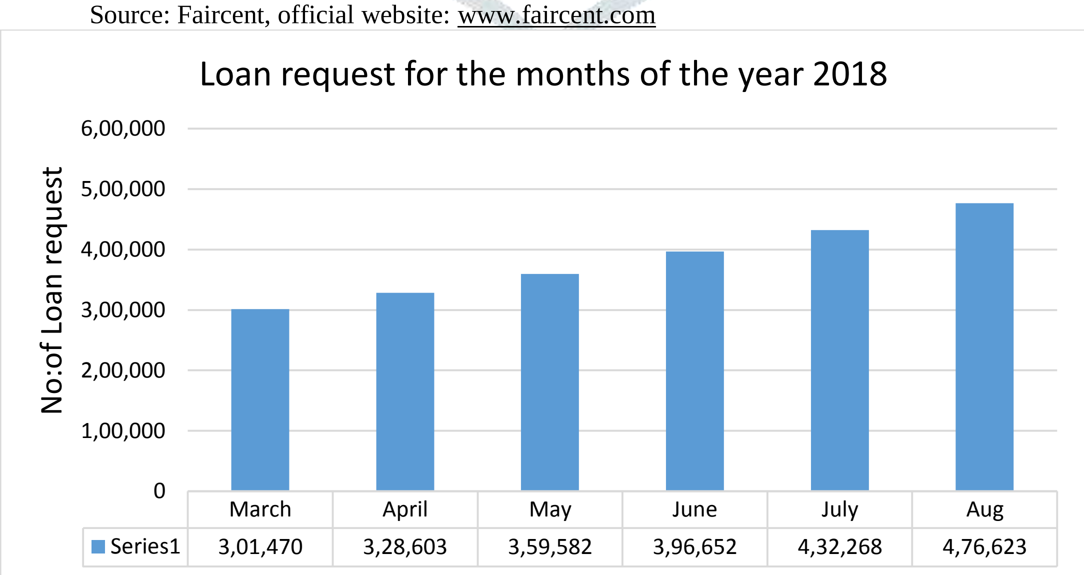
Leading P2P Lenders in India

Globally P2P lending has been in existence for more than ten years; however, it has been evolving in India in the last couple of years. Given the recent RBI guidelines, companies will now need to obtain NBFC–P2P license and will come under the purview of the regulator. There are more than 50 P2P online platforms operating in India. I-Lend, LenDenClub, Faircent, Lendbox, i2iFunding, Monexo, India Money Mart, Rupaiya Exchange are some of the leading P2P platforms operating in India. The origin of P2P lending in India can actually be traced back to 2012 when Shankar Vaddadi and his team established i-Lend. I-lend is India's first social lending initiative that brings together borrowers and lenders to facilitate a financial transaction.

India's largest P2P lending platform Faircent.com has *received its NBFC-P2P certification from the Reserve Bank of India (RBI)* on May 2018. The accreditation makes Faircent.com the first P2P lending platform in the country to receive the certificate of registration as an NBFC-P2P by the national regulator. It started in the year 2013 by Nitin Gupta, Rajat Gandhi and Vinay Mathews. It is headquartered at Gurgaon, Haryana. Performance status of Faircent.com for the year 2018 are as follows:

Month	**Loan request by customers (in No.)**
March	3,01,470
April	3,28,603
May	3,59,582
June	3,96,652
July	4,32,268
August	4,76,623

Source: Faircent, official website: www.faircent.com



Growth Prospects of P2P Lending.

- Increasing digital penetration and growing awareness of digital transactions.
- An alternate asset class for retail investors.
- High unmet financial demand from individuals who face difficulty in obtaining finance from traditional banking and NBFC system.
- With the sector coming under the purview of RBI, there will be better transparency in the system and higher confidence amongst participants.

Key Challenges of P2P Lending.

- Likely higher default risks on account of unsecured lending and risky borrower profile.
- Ability of the P2P operator to assess borrowers based on their credit models on a larger scale is yet to be demonstrated.
- Direct credit risk on the investors on account of lack of guarantee or liquidity support from the platform.
- Sustainability of P2P operator with respect to financial, operational, liquidity and reputation risks.
- High competition from traditional chit fund model, microfinance entities, small finance banks and NBFCs engaged in low ticket size retail segment.

Conclusion

Although online P2P lending is a relatively young field of research an increasing amount of scientific contributions has been published in recent years. It transfers the old idea of personal credits into the World Wide Web. For borrowers, online P2P lending is a way to receive a loan without a financial institution involved in the decision process and might also be a possibility to receive better conditions than in the traditional banking system. For lenders it can be seen as an investment model where the investment risk is coupled to the credit rating of the funded loans. P2P lending companies may bear less transaction costs than conventional financial institutions do, since its business model is simpler. They do not capture deposits, they are not under strict banking regulations and they do not maintain idle balances but they just put borrowers in contact with lenders.

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