P2P Lending

Newsletter

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Peer to Peer Lending(P2P)

'Peer-To-Peer Lending (P2P): Meaning

Peer-to-peer (P2P) lending is a method of lending and borrowing alternate to the banking system which enables individuals to borrow and lend money without using an official financial institution as an intermediary such as banks and other finance providers. Peer-to-peer lending provides a direct platform to the borrowers and removes the middleman from the financing process but it involves more risk than the general scenarios as everything is done through online portals.P2P lending is also known as social lending or crowd lendingor crowd funding.

Individuals and small businesses those are in need of fund generally opt for conventional method of financing, i.e. through the bank.Allbanks usually have certain norms and procedures for ensuring the credibility of a person before granting the funds. The banks run an extensive financial checks on the applicant's credit history to determine if the person would qualify for a loan or not, and if yes, determines the interest rate that will be charged on the loan.

Usually banks charge a very high rate of interest and their norms are also tight that some individuals may not be able to fit in their criteria of eligibility. P2P is an alternative to those individuals who want to avoid being charged high interest rates or whose files have been rejected for a loan application.

In P2P, there may be single or multiple lenders for one borrower and single or multiple borrowers for a single lender but monthly repayment has to be made to each of the individual sources.

How does it work?

Firstly, the lenders have to decide the amount of investment and the time frame for which they can invest the amount.Some P2P companies offer the option to withdraw the funds during the loan term also. But there may be a cost for doing this and the lenders have to wait until another lender comes in to replace.

Operation model in India

In India, P2P lending platforms can be provided by a Company registered with RBI.The Companies provide an online platform and must adhere to the provisions of the Information Technologies Act as well. The borrowers and lenders needs to register

themselves on the portal. The Company carries out a due diligence and after ascertaining all the relevant factors such as identity, genuineness and credibility, allows them to participate in the process.

The interest rate is also fixed separately over the electronic platform by way of a mutual agreement between the borrower and lender. On the P2P lending platform, the fund is transferred between participants using escrow account mechanisms as fund transfers shall be through and from bank accounts only because cash transactions are prohibited.

P2P Worldwide

Lending through P2P platformsat the end of Q4 of 2015 globally had reached 4.4 billion GBP (approximately Rs 38,300 crore) from 2.2 million GBP (about Rs 19 crore) in 2012.

At present, China has the largest P2P market in the world, with hundreds of platforms offering diverse services, but the sector is not regulated in the country whereas, countries likeGermany Australia, Italy, New Zealand, Canada, Argentina, United Kingdom, France, and USA have regulated P2P lendingpartially or fully while it is fully banned in Israel and Japan.

P2P Platforms in India

Until year 2017, there was no regulation to regulate the business of P2P lending but in the later 2017, RBI vide its Notification issued on 24th August, 2017, has regulated the P2P entities to be registered as Non-Banking Financial Company (NBFC).

Furthermore, the platforms are not permitted to hold funds received from lenders, or funds received from borrowers for servicing loans in their balance sheet. In addition, the platforms are also prohibited to permit any international flow of funds.

P2P platforms have to undertake certain responsibilities as an intermediary towards the lenders and borrowers of such platforms:

- To undertake due diligence of the prospective lenders and borrowers.
- To carry out risk profilingand credit assessment of the borrowers and reveal the same to the prospective lenders.
- To receive prior consent of the participant to access its credit information.
- To carry out documentation of loan agreements and other documents.
- To support in disbursal and repayment of loan amount.
- To facilitate recovery of loans originating on the platform (by using fair means).
- To seek the redressal of grievances of the stakeholders.

As regard to the capital requirement, the RBI has fixed minimum net worth requirement for these platforms as Rs. 2 Cr. The borrower can either be any person whether natural or artificialsuch as individual or a legal person (say a body of individuals, a HUF, a firm, a society or any artificial body, whether incorporated or not) requiring a loan.

The RBI has set some prudential norms to be observed by P2P Companies while conducting their business such as:

1) NBFC-P2P shall have to 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, should not exceed Rs. 10, 00,000/-.
3) The aggregate loans taken by a borrower at any point of time, across all P2Ps, should not exceed Rs. 10, 00,000/-.
4) The exposure of a single lender to the same borrower, should not exceed, across all P2Ps, Rs. 50,000/-.
5) The maturity of the loans shall not be more than 36 months.
6) P2Ps have to obtain a certificate from the borrower as well as from thelender that the limits prescribed above are being adhered to.

As the loansraised via these platforms are unsecured in nature and the Fair practices Code also provides that platform shall not provide any assurance for the recovery of loans and that *'there exists a likelihood of loss of entire principal in case of default by a borrower',* hence the maximum exposure limits are set low.

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 regulatory concerns in such cases would relate to KYC (know-your-customer) and recovery practices. Since all payments are through bank accounts, the KYC exercise are deemed to have been carried out by the concerned banks.

Crowdfunding in the News Recently:

Crowdfunding raises ₹40L for Unnao, Kathua victims' kin

It is really a good initiative by **Mr. Bilal Zaidi,** the co-founder of **CrowdNewsing,** who recognizes the Crowdfunding platform as a social platform to provide financial aid to the victims' of Unnao and Kathua.

"**Bilal Zaidi,** initiated the campaign, called us and asked us to furnish details and the fund was transferred into our account about a week ago," the Unnao rape survivor's uncle

said. He added the family hadn't decided what to do with the money, yet. "We are in a legal battle which is cost-intensive. Chances are we would use the funds to pursue the case."

"Most of our initiatives look forward to creating an impact in the lives of people. As many as 1,575 people from different walks of life came forward to gather Rs 40 lakh for the families," he said.

The campaign, which began on April 14, reached its target in four days. A sum of Rs 18 lakh each was transferred to the accounts of the two families. The remaining amount went into formalities and paying taxes. The single highest contribution was of Rs 60,000. This was followed by several donations of Rs 51,000 and Rs 50,000.

The family of the Kathua victim has said it will use the money to start a school for girls from the Bakarwal tribe. "They want their children to get better education and we hope this financial support will be of use to this tribal family," said Anand Mangnale, co-founder and director of campaigns for crowdfunding website **Ketto**, which facilitated the campaign.

Observations:

Peer-to-peer intermediaries are profit making companies that provide an online platform which matches borrowers and individual lenders. Individuals and businesses that need funding for personal or commercial projects need to file an application with these intermediaries which will assess their credit risk, determine a credit rating, and apply an interest rate to their profiles. P2P intermediary also facilitates the repayment of loan and forwards the payments to the lenders who invested in the loan through secured banking channels.

As the RBI is regularizing P2P, more lenders and borrowers have started using P2P for loans, which is going to expand the market in future. These platforms bring the unorganized money lenders to a formal platform by making borrowing/ lending through banking channels and regularizing the unorganized sector of the India. Small lenders lend their surplus funds in a transparent manner which yields them higher rate of return as compared to bank deposits. As the P2Ps Companies are registered as NBFC first with the RBI, this brings more transparency and compliance by such companies.

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