The Other Side May 12, 2016

P2P: Old wine in new bottles?

The business media has been full of reports and comments on Peer to Peer Lending (P2P) in recent weeks, particularly after publication of a discussion paper by the RBI last month. In a way, there is nothing totally new about the concept: in principle, the "*bhishis*" of housewives in most co-operative housing societies in Mumbai are a form of P2P: so are the age-old "chit funds". At a different level, public issues of corporate bonds are also a form of lending by the individual saver to the issuer of the bond – and so are money market and bond funds. The basic feature of all these arrangements is that the saver directly takes the credit risk on the borrower, without the intermediation of any bank or finance company. The securitization of loans by banks also means exactly the same thing: to be sure, there is, in theory, an intermediary, namely a nominally capitalised entity ("special purpose vehicle", SPV) which buys bank debts, and issues securities backed by these assets for sale to investors.

The main distinguishing feature of P2P is that the loan amounts are relatively small, say up to Rs. 1 lac (but so are they in *bhishis* and chit funds), and the transaction is arranged on an electronic platform managed by the promoter, who gets a fee for the service. The numbers I have read for the interest and the fee are of the order of 20% p.a. and 5% of the loan amount. Clearly, not many businesses would be able to afford P2P – unless their business margins are high enough, or they are borrowing at an even higher rate. Or would the loans be for consumption expenses like marriages? They may also overlap with micro finance institutions.

MFIs remind me of how we seem to be prone to acceptance of a new model of financial intermediation without weighing the risks: remember the craze for leasing companies at one time with every Rajaram, Sitaram and Tukaram promoting a leasing company. Few survive today, and my memory is that even the most successful one (based in Chennai) is in difficulties. There has also been a shakeout in the MFI sector.

But coming back to P2P, one thought occurs to me: regulation should require the platforms to hold "x" % of each loan on their own books – this would hopefully make for more responsible scrutiny of the borrower and credit risk. (Or should only established banks/NBFCs manage them?) The RBI discussion paper estimates the global size of the P2P sector at GBP 5 bn. However, this seems to be a significant underestimate. China alone has outstanding P2P loans of the order of $ 80 bn equivalent, on 4000 platforms. (After the failure of one of the largest platforms the central bank is now trying to bring in some regulation.) And, one student loan P2P platform In the US (“SoFi” – short for “Social Finance”) was recently the first US P2P to fund $ 5 bn of loans and is fast on the way towards $ 10 bn.

At the other end, brick-and-mortar banks from Goldman to the Development Bank of Singapore (DBS) are opening e-accounts – with no signatures, and cash withdrawals only from ATMs. Many banks are computerising the processing of consumer and mortgage loan applications and Citibank recently estimated that with full computerization of data analysis, banks in US and Europe may be able to reduce up to 5 mn jobs over the next 10 years. In India, NSE’s bill discounting platform may also do well given the size of debtors and creditors on the books of businesses. (Remember where Uday Kotak started?)

In another traditional banking service, the prospects of e-wallets and mobile based payment services look more attractive. The key, as in the case of the electronic currency bitcoin, is how many businesses will feel comfortable in getting paid through such mechanisms. The other side is the recent case of the fraudulent transactions in the USD account of the Bangladesh central bank with the US Federal Reserve a few weeks back using the SWIFT (Society for Worldwide Interbank Financial Transactions) network. SWIFT handles trillions of dollars of transactions every day and surely has the most sophisticated, and error- and fraud-free systems in the world. What the Bangladesh bank case proves once again is that no system is hacker proof. The bank has so far lost $ 80 mn – and SWIFT has recently admitted to similar other, unpublicised incidents as well.

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