White Paper Analysis
Digital Lending-An Alternative Investment Opportunity

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Introduction

Digital lending, also known as Peer to Peer (P2P) lending, is the practice of lending money to individuals or businesses through online platforms that match lenders with borrowers. Digital lending companies offer their services online, and attempt to operate with lower overhead and provide their services more cheaply than traditional financial institutions. As a result, lenders can earn higher returns compared to savings and investment products offered by banks and borrowers can also borrow money atlower interest rates.Digital lending platforms take fees for providing the match-making platform and credit checking the borrower.

Digital Lending is also known as **Crowd Lending**sincethe whole network works on many to many relationships. Most peer to peer loans are unsecured personal loans like education loans, Loan for marriage or any function, Medical Emergency, Vehicle loans, etc. Although some of the amount also lent to businesses.

Why it has evolved?

For lender or Investor perspective, since last couple of years the interest rates of bank deposits have been reduced and same applies to Post office schemes and other government schemes. Today the FD generates interest rates of around 5% to 6%. Investor has no option to earn a good amount of returns on regular basis by keeping their money on lower risk avenues or other Investment options.

For borrowers perspective, to get personal loans from banks or NBFCs has become costly and that also requires some collaterals or securities to be submitted in return. People can also easily borrow money from Individual lenders called as shroffs at higher interest ratesbut their recovery mechanism may get harsh sometimesin case of failure of repayment.

As we know now a days our financial world is evolving drastically due to thousands of innovative products or strategies, Involvement of technology, Artificial Intelligence, etc. The last decade has seen a number of financial innovations. Crypto Currency, blockchain technology, ETFs and Peer-to-Peer (P2P) lending are some of the new financial avenues which shifts the variety of investments options from big banks and the deepest pockets to the smart individuals and start-ups.

History in India:

In India the lending culture is too old. Earlier there were Shorffs who lent money to the borrowers at higher interest rates and took some collateral or securities. Then organised banking and NBFC culture has been introduced but still for personal loans majority of Indians rely on their friends, family members, money lenders, and business associates for borrowing money even today. In India there is still a huge unregulated market of unorganised Lending, which considers being a very high risky option in the hands of lenders as well as borrowers both.

But since 2017, as RBI issued directions to NBFC to get P2P lending certification, the largest offline crowd funding market of the world - India is now also evolving to be a giant online Digital lending (P2P) marketplace. As on August 31, 2019, 19 companies have been granted licenses by the Reserve Bank of India. Now digital lending in India is growing fast since it satisfies both borrowers and lenders objectives. Now many institutions and big players are coming in to this business.

Global Market:

Digital Lending had initially started in United Kingdom in 2005 and then subsequently other players were coming and in since 2014 the peer-to-peer lending industry has been regulated by the Financial Conduct Authority to increase accountability with standard reporting and facilitate the growth of the sector.

After UK, in USA also digital lending had started in 2006. More people turned to peer-to-peer companies for borrowing following the financial crisis of 2007–2008 because banks refused to increase their loan portfolios. The peer-to-peer market also faced increased investor scrutiny because borrowers' defaults became more frequent and investors were unwilling to take on unnecessary risk. In 2008, the U.S. Securities and Exchange Commission (SEC) required that peer-to-peer companies register their offerings as securities, pursuant to the Securities Act of 1933.

After the success of business model in western markets, Digital lending has developed its market in different countries across the globe and today the model is running successfully and updating its regulations and models day by day.

Characteristics:

Digital Lending is a new aged alternate financial service driven through FinTech platforms on which one borrower and on lender unknown to each other can join and initiate the transactions. The interest rates can be set by lenders who compete for the lowest rate on the reverse auction model (to earn higher interest rate) or fixed by the intermediary company on the basis of an analysis of the borrower's credit.

On some services, lenders mitigate the risk of bad debt by choosing which borrowers to lend to, and mitigate total risk by diversifying their investments among different borrowers.

Fintech intermediaries are for profit businesses; they generate revenue by collecting a one-time fee on funded loans from borrowers and by assessing a loan servicing fee to investors or borrowers (either a fixed amount annually or a percentage of the loan amount). Compared to stock markets, peer-to-peer lending tends to have both less volatility and less liquidity. This is less flickery than equity investments.

<u>Why to pay EMIs rather Earn in form of EMIs?</u>

- To get monthly cash flows in the form of EMIs (Principal + Interest).
- Your money is being lent to not only one but so many borrowers as per the category you choose.
- You don't need to find borrowers by your own. That task is being done by the P2P platform.
- You will have an option to get cash flows credited in your bank account or you can reinvest the same to new set of borrowers.
- You will also get to know the basic details of your borrowers. (can't connect directly)
- To get higher returns compared to other fixed income avenues by taking managed and diversified risk.

<u>Credit Risk:</u>

Digital lending also attracts borrowers who, because of their credit status or the lack thereof, are unqualified for traditional bank loans. With likelihood of default, peer to peer intermediaries have started to decline a large number of applicants and charge higher interest rates to riskier borrowers that are approved. They have their own criteria of finding good borrowers so that they can try to mitigate the risk of default. Still the business itself has a high risk of delays and defaults. They have NPA ratios to identify their default risk.

Lenders or borrowers can be any entity having PAN card other than NRIs. This model has made huge impact on SME segments and salaried people through which they can easily get the loans and increase their spent capacity. Any individual having age below 18 is not eligible

Amount invested by lenders through P2P platforms is being pooled in Escrow account with bank which is maintained by trustees appointed by RBI. Then after through algorithm and online mechanism that amount goes to the different borrowers as per the categories selected by the investors.

<u>Important Limits:</u>

As per RBI guidelines Lenders/ Investors can invest up to maximum limit of **INR 50 lac** per PAN card and for borrowers, to apply for loans that limit is restricted to **INR 10 lacs** per PAN card. For investors to invest above **INR 10 lacs** they need Networth certificate from practicing chartered accountant. For minimum investment different platforms have their internally decided limits.

Taxation and Legal:

Income generated through digital lending is taxable as Interest Income under the head Income from other sources as per slab rates. There is not deduction of TDS as of now in India on P2P lending income. This product is more suitable to the person having lower tax brackets. High tax bracket investors sometimes do not like highly taxable products.

On legal side borrowers and lenders both are covered by legal agreements and can be sued in the eye of law in case of any conflicts.