Expert Opinion: What Peer-to-Peer (P2P) Lending Means to Borrowers in 2019 and Beyond

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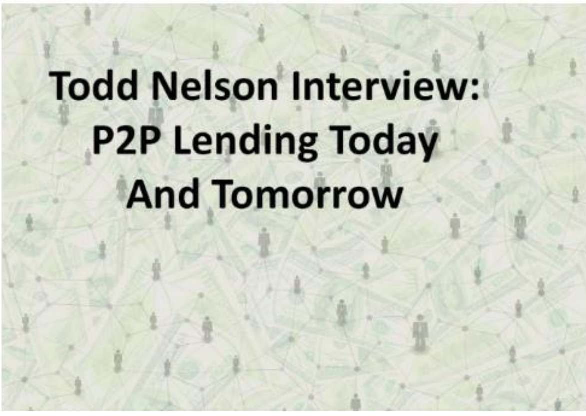


Peer-to-peer lending, or P2P as many call it, is a fairly recent development in personal finance, and it's still evolving. In its most basic form, P2P platforms introduce investors who wish to lend money and applicants who wish to borrow. The idea is to simplify the process, democratize personal lending and eliminate the middleman.

But it turns out that P2P isn't as simple as all that. Todd Nelson is the Senior Vice President of Strategic Partnerships at SunTrust Bank (LightStream) and a widely-recognized voice and thought leader in the industry. We are fortunate to get his expert take on P2P and its future impact on consumers.

See personal loan interest rates

The "peer" in peer-to-peer is changing

The popularity of P2P caused traditional lenders to take notice, and some have endorsed the trend. Similar to the way many traditional taxi drivers now accept fares from ride-sharing outfits like Uber and Lyft to stay profitable. The full-time drivers had to change the way they work to compete with part-timers and apps.

Todd Nelson believes that this evolution in P2P lending is a positive development.

"The growth of P2P lending is a good thing for consumers," he says. "P2P lending was an innovative concept for a time when consumer credit had retracted tremendously. "

Technology and the democratization of personal lending has broken the monopoly of "big guys" on financing for "little guys."

Nelson explains, "Chris Larsen is truly the Godfather of Fintech, having founded e-Loan, Prosper and Ripple. He deserves a lot of the credit for his far-sighted concept of P2P lending. Allowing individual investors to participate in funding consumer lending, and essentially dis-aggregating the asset-backed securitization process was truly visionary.

"Today, there are more lenders with better offers — and this greater set of choices is better for consumers."

Who is the P2P borrower?

A May 2019 FDIC paper, *Financial Innovation and Borrowers: Evidence from Peer-to-Peer Lending* by Tetyana Balyuk analyzed borrowers from Prosper, one of the largest peer-to-peer platforms in the country. Researchers found that taking out and repaying peer-to-peer loans increased consumers' access to credit from other sources like banks.

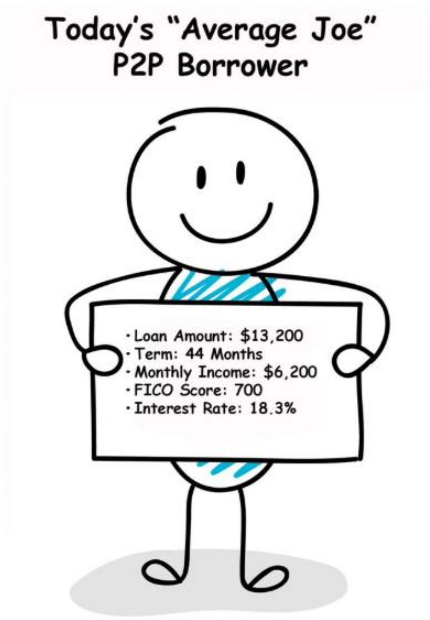
P2P borrower FICO scores tend to skew a little lower than the general population, and researchers found that getting a P2P loan does make it easier for these consumers to then borrow from other sources. As though a P2P loan creates a "stamp of approval" for these consumers.

Here are the ranges of borrower income and credit score, loan amounts (this particular lender's maximum loan is $35,000) and terms of P2P borrowers in 2018, courtesy of the FDIC:

- FICO score: minimum 650, maximum 810
- Monthly income: minimum $0, maximum $21,800
- Loan amount: minimum $2,000, maximum $35,000 (the limit for this lender)
- Loan term: minimum 12 months, maximum 60 months
- Interest rate: minimum 6.4%, maximum 36%

This represents the average Prosper borrower, according to the FDIC research:

Data courtesy of the FDIC



Data courtesy of the FDIC

How does fintech benefit you when you borrow?

Most consumers don't really care about "gee whiz" technology unless it improves their own lives and experience. But fintech (financial technology) is one of those things we can get excited about, explains Nelson. That's because the participation of larger institutions increases the funds available to borrow, while competition from individual lenders keeps pricing down.

"Today, very few consumers actually participate in funding these loans, as scaling those businesses requires institutional investors who can bring more capital to lend. Banks have embraced the unsecured lending space in a big way, and will dominate the category in the future because of their scale, lower cost of funds and large customer bases.

"SunTrust became one of the early leaders, acquiring FirstAgain and relaunching it as LightStream in 2013. It combined the consumer centric, tech-savvy elements of a FinTech company with the strength and balance sheet of a bank."

Todd Nelson believes the entry of large-scale businesses like Lightstream into the P2P space is a positive for consumers.

"This has proven to be a massive advantage in better serving the consumer and growing the category. As a result, consumers are getting a better borrowing experience, lower interest rates and access to funds without having to pay fees."

The future of personal lending? Lower rates

Almost any great new idea can be improved. The original inventor(s) visualize a new way of doing things, launch a product or service, and then others jump in and strive to improve it and compete in the space. That's what's happened with peer-to-peer lending, Nelson explains.

First, the invention: "Like many innovations in financial services, P2P started outside traditional banks and financial service companies. They were created by entrepreneurs to serve a specific consumer need, in a smart, nimble and innovative manner. In the absence of better alternatives, P2P lending was attractive for consumers."

And then, the improvement and competition: "As the category evolved, bank-funded companies emerged, offering lower rates, no fees, larger loans and a better customer experience for prime credit borrowers. This may force P2P lenders to either move down market to riskier credit segments, or pivot to become software platform providers, rather than lenders, in order to survive."

And competition and consolidation will continue to fuel change: "In the end, companies like Avant (Amount) and Figure might have a brighter future in licensing their software and technology to banks, rather than trying to originate loans and compete against them."

Common misconceptions

There are common misperceptions among consumers about unsecured lending. (For instance, AmOne surveys find that many still fund large purchases with credit cards, despite their often significantly higher interest rates.)

Todd Nelson agrees. "Many assume unsecured lending means higher interest rates. While that may have been true in the past, it's not necessarily true today. Some borrowers may find unsecured loans starting at 3.99%, with no fees.

“Historically, unsecured lending was the ‘loan of last resort’ for lenders who preferred to have collateral behind every consumer loan. As a result, consumers paid higher rates for unsecured loans.

“That began to change, when companies like FirstAgain–who understood consumer credit risk for prime credit borrowers–were able to demonstrate that for the right borrower, the loan purpose and collateral were less important.”

In addition, consumers may believe that it takes a long time to get a personal loan. Same-day funding is possible in certain cases.

Unsecured loan uses

“The beauty of an unsecured loan,” says Nelson, “Is that it can be used for a variety of purposes.”

While many use personal loans for debt consolidation, these products can be the best way to finance many things — including cars, boats, aircraft, medical fees, adoption, horses, home improvement, vacations, weddings and more. The online processing is fast, interest rates start at very low levels, and terms range from two to 12 years.

Nelson reiterates, “People should understand that unsecured lending is not just for debt consolidation. That said, for most P2P companies it is true that most of their customers are simply refinancing credit card debt to an installment loan.

It’s important that consumers shop for their personal unsecured loans. Pricing can vary widely. Some lenders do not charge fees, but that not always be true among lenders, so consumers must verify fees before committing to a product.

It’s the combination of fees and interest rate that makes a loan a good or bad deal for you. Personal loan interest rates, says Nelson, can be “competitive for buying vehicles or tackling home improvement projects.”

Find the lender that matches your needs

Not all lenders occupy the same space. Consumers should shop to make sure that they find the lender that offers the most competitive deal for those with their credit profile and desired loan terms.

Certain companies focus primarily on consumers with good to excellent credit and compete aggressively for that business. If that’s not your profile, other companies and individuals competing in non-prime markets might offer you a better deal.

Personal loans versus home equity loans

Lenders (P2P and others) have been increasing personal loan limits in recent years. While many platforms max out at $35,000, borrowers can find much larger loans today. Todd Nelson says that LightStream offers loans up to $100,000.

So how does this affect the decision to choose unsecured financing versus a home equity loan? Home equity loans, being secured, often (but not always) come with the lowest interest rates for many uses. Depending on your needs and the desired loan term, an unsecured loan could beat home equity in certain cases.

Compare personal loan programs