Deutsche Bank Research

July 2007

The power of people

Online P2P lending nibbles at banks' loan business

New online lending platforms match people who need a small loan with those who have extra cash to lend. Person-to-person (P2P) lending sites aim to save costs by brokering loans without a retail bank directly between individual savers and lenders. P2P loans are unsecured, and although the lending sites typically do not guarantee repayment they do use a number of instruments to assess and limit credit risk, such as providing information on the borrowers, diversification of funds across many loans, and peer pressure to shame delinquent debtors. chart 1

Online P2P lending platforms sprawl. In 2005, Zopa in the UK was the first site. In the meantime, P2P lending sites have also popped up in the US and continental Europe. The business models differ, however: Zopa, for instance, does not showcase individual borrowers and matches savers with borrowers itself. The Californian outlet Prosper allows borrowers to explain publicly who they are and why they need the money. They may also organise in groups whose reputation (good, if all members pay on time) will affect the creditworthiness. Prospective lenders bid directly on individual loan requests. chart 2

Not all loans are serviced according to plan. Zopa says that its lenders experienced less than 0.2% bad debt, but Zopa does not lend to riskier borrowers. At Prosper, about 5% of loans (by volume) older than 6 months have been defaulted on, and there are payment arrears on nearly 10% of loans. chart 3

Lenders ignore high-risk borrowers. Lenders bear the entire credit risk (except at Germany's Smava). Little wonder that they prefer low-risk borrowers. At Prosper, around 45% of loan requests by borrowers with an AA credit grade are being funded, but only 2.5% of those by high-risk borrowers. chart 4

Margins on low-risk loans are already razor-thin. Low-risk borrowers also qualify for cheap, standardised retail loans from traditional banks – this pitches P2P platforms into cut-throat competition. Examples from Germany illustrate how little room there is between the cheapest loan offer and the most generous – and in contrast to P2P lending, risk free – savings account. Thus it seems unlikely that P2P lending can ever be more than a niche product in this segment. chart 5

High-risk borrowers and non-standard loans are the untapped potential for P2P lending. Prosper has brokered loans worth around USD 69 m so far but had unfunded loan requests of more than USD 467 m. Unfunded high-risk loans make up USD 227 m (49%) of that pool. Albeit widely neglected so far, competition from traditional banks might push P2P sites increasingly towards these loans. This does not necessarily have to be a bad thing because here they can leverage their unique community power. chart 6

Peer pressure improves payment discipline of high-risk borrowers. Some P2P platforms use the power of their communities to screen and assess borrowers and to pressure for repayment. Moreover, some fickle debtors may feel more obliged to repay "real people" rather than an impersonal bank. Evidence from Prosper illustrates the difference peer-review and peer-pressure can make: default rates are typically much lower if borrowers have joined (and were accepted by) a group of borrowers – this holds in particular for high-risk and non-rated borrowers. chart 7

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Looks like Ebay

Snapshot of Prosper.com loan listings as of 27 June 2007

I'd like to stop paying my bank.... (No group)	$14,500.00 @ 16.00% A credit grade 43% DTI	82% funded 113 bids
Credit Repair/Debt consolidation (No group)	$5,000.00 @ 29.00% D credit grade 16% DTI	81% funded 57 bids
AA 2nd Time Borrower - Writing a Manuscript (No group)	$3,200.00 @ 11.54% AA credit grade >1000% DTI	80% funded 17 bids
I need dental implants for 3 missing teeth KING FINANCIAL GROUP///100% CASH FLOW SOLUTIONS FOR YOU ★★★★★ (67)	$5,000.00 @ 15.22% B credit grade 32% DTI	79% funded 48 bids

Source: Prosper as of 10 July 2007 **1**

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Online P2P lending platforms sprawl

Examples

	Region	Loan volume (Since inception, USD '000)
Boober	NL	1,332
Kiva	Developing countries	7,900
Prosper	US	69,388
Smava	DE	217
Zopa	UK	Not published

Sources: Booberwatch.nl, Kiva.org, Wiseclerk.com as of June 2007 **2**

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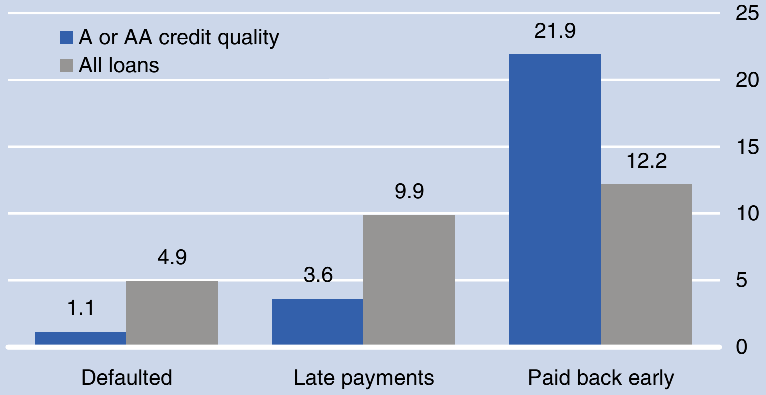
Not all loans are serviced according to plan

% of total loans older than 6 months at Prosper

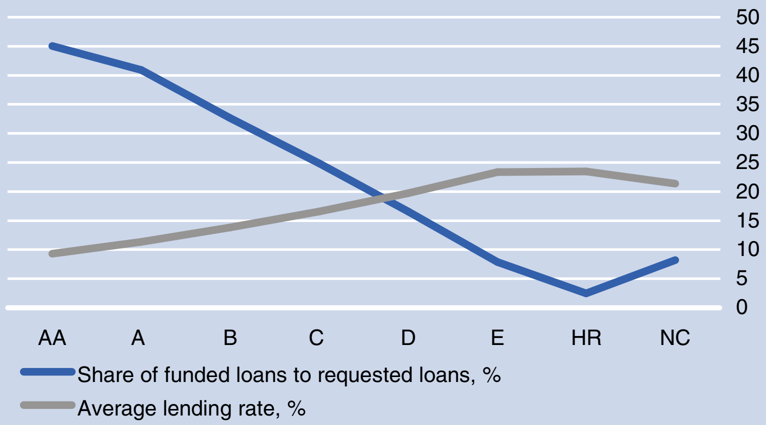


Sources: DB Research, Prosper as of 26 June 2007 **3**

Zopa says that its lenders experienced less than 0.2% bad debt, but Zopa does not lend to riskier borrowers. Not all loans are serviced according to plan. At Prosper, about 5% of loans (by volume) older than 6 months have been defaulted on, and there are payment arrears on nearly 10% of loans. Moreover, more than 21% of low-risk loans (with a credit grade of A or better) have been paid back earlier than agreed. This exposes lenders to re-investment risk because they have to find new and similarly profitable investments. back to front page

Need to convince more lenders

Share of funded loans to requested loans and avg. lending rate at Prosper



Credit quality decreases from grade AA to E; HR=high risk; NC= no credit score

Sources: DB Research, Wiseclerk as of 12 June 2007 **4**

Lenders ignore high-risk borrowers. As lenders bear the entire credit risk (except at Germany's Smava), they prefer low-risk borrowers. At Prosper, around 45% of loan requests by borrowers with an AA credit grade are being funded, but only 2.5% of those by high-risk borrowers. Lenders yield higher interest on riskier loans, but apparently, this extra yield does not suffice to compensate for the extra risk. back to front page

Razor-thin margins in German retail finance

Best rates, including online-only offers and promotions, on EUR 10,000 for 36 months, %

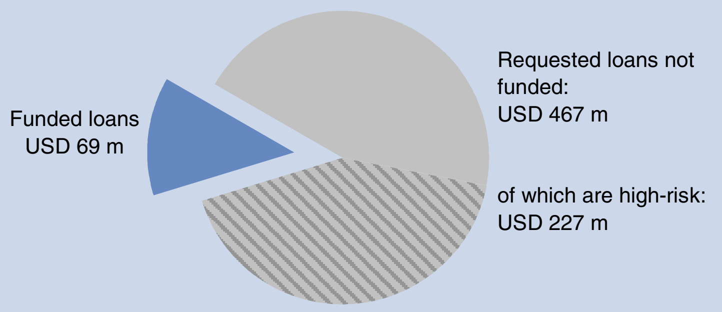
Savings	Loans*
4.3	4.4

*Depending on creditworthiness. Source: aspect online, as of 5 July 2007 **5**

Margins on low-risk loans are already razor-thin. Low-risk borrowers also qualify for cheap, standardised retail loans from traditional banks – this pitches P2P platforms into cut-throat competition. Examples from Germany illustrate how little room there is between the cheapest loan offer and the most generous – and in contrast to P2P lending, risk free – savings account. Thus it seems unlikely that P2P lending can ever be more than a niche product in this segment. back to front page

High-risk borrowers are untapped potential

Requested and funded loans at Prosper, since inception



Sources: DB Research, Wiseclerk as of 12 June 2007 **6**

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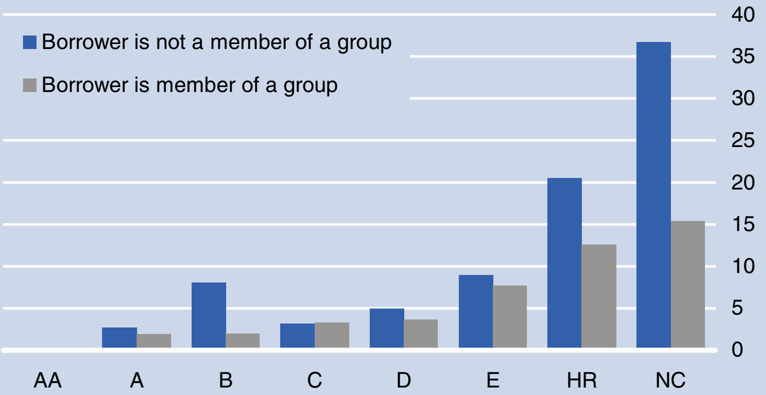
Groups keep high-risk borrowers in check

Default rate on loans older than 6 months at Prosper, %



Sources: DB Research, Prosper as of 26 June 2006 **7**

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