ISSN: 2348-473X
Peer Reviewed & Refereed Journal (IF: 6.74)
Journal Website: www.nrjss.in

CREDIT RISK ASSESSMENT MODELS IN PEER-TO-PEER LENDING: A SYSTEMATIC REVIEW AND FUTURE DIRECTIONS

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ABSTRACT:

Peer-to-Peer (P2P) lending platforms have transformed the traditional lending landscape by enabling direct interactions between borrowers and lenders through online platforms. This disintermediation, while improving efficiency and accessibility, has also led to a reconfiguration of how credit risk is assessed. In traditional financial institutions, credit scoring mechanisms are well established and regulated; however, P2P platforms face distinct challenges due to limited borrower data, lack of standardized evaluation protocols, and the increased heterogeneity of borrower profiles. This article presents a comprehensive systematic review of credit risk assessment models used in P2P lending, covering both conventional statistical methods and contemporary machine learning-based approaches. The paper explores their effectiveness, key differentiators, and current limitations, and identifies future research avenues for enhancing model performance and transparency. By bridging the gap between traditional credit scoring frameworks and emerging AI-based models, the study aims to guide both academic researchers and industry practitioners.

Keywords: Peer-to-Peer Lending, Credit Risk, Machine Learning, Credit Scoring, Risk Assessment Models, FinTech, Explainable AI

1. INTRODUCTION

The financial services industry has undergone rapid transformation in the past decade with the advent of FinTech innovations. One of the most disruptive among these is Peer-to-Peer (P2P) lending, which allows borrowers to access credit directly from individual or institutional lenders through digital platforms, bypassing traditional banking intermediaries. This new lending paradigm is particularly attractive to underserved segments who face barriers in accessing credit through conventional channels. While P2P lending has democratized credit access, it has simultaneously introduced new layers of risk—especially credit risk. Unlike banks, which have access to rich credit histories and utilize robust regulatory frameworks for underwriting, P2P platforms often operate with limited borrower data, informal verification mechanisms, and a high degree of variance in loan purposes and borrower intent. This makes the accurate prediction of loan defaults both more critical and more challenging. Given the high default rates reported by some P2P platforms, the need for effective credit risk assessment is paramount. Early-stage platforms used traditional statistical models such as logistic regression. However, as the volume and variety of data increased, machine learning (ML) and artificial intelligence (AI) models began to show promise due to their ability to capture complex, nonlinear patterns in data. The shift towards data-driven and algorithmic decision-making, while improving predictive accuracy, has raised concerns regarding model transparency, bias, and data privacy. This paper aims to provide a systematic review of credit risk assessment models used in P2P lending, analyzing their methodologies, comparative effectiveness, and future directions for research and practice.

2. LITERATURE REVIEW

2.1 Traditional Credit Scoring Models

Traditional models like Logistic Regression (LR), Linear Discriminant Analysis (LDA), and Probit Regression have long been employed for credit risk prediction. These models rely on assumptions of linearity, normal distribution, and feature independence. Studies such as Lessmann et al. (2015) have demonstrated the limitations of these models in handling complex, nonlinear data, which is typical in P2P lending. Nonetheless, their ease of implementation and interpretability continue to make them popular for baseline comparisons.

2.2 Machine Learning Approaches

Machine learning models have been increasingly applied in P2P credit scoring due to their capacity to handle large, high-dimensional datasets. Decision Trees, Random Forests, Gradient Boosting Machines (GBMs), Support Vector Machines (SVM), and Neural Networks have all been employed with varying success. Khandani et al. (2010) showed that Random Forests could outperform traditional models in consumer lending scenarios. Malekipirbazari and Aksakalli (2015) demonstrated the effectiveness of Random Forests in improving default prediction on LendingClub data.

2.3 Hybrid and Ensemble Methods

Combining multiple algorithms, either through stacking or voting techniques, has been shown to yield higher predictive accuracy and robustness. Turiel and Aste (2019) explored ensemble learning using Random Forests, Gradient Boosting, and Logistic Regression for acceptance and default prediction. The hybrid approach offers a compromise between accuracy and interpretability, which is crucial for real-world deployment.

2.4 Explainable AI (XAI)

A growing concern in using complex ML models is their black-box nature. Tools like SHAP (Shapley Additive Explanations), LIME (Local Interpretable Model-Agnostic Explanations), and Integrated Gradients are now being used to make AI decisions more interpretable. Poursafaei et al. (2022) highlighted how explainability in credit scoring can improve stakeholder trust, regulatory acceptance, and model accountability.

3. RESEARCH GAP AND OBJECTIVES

Despite significant progress, several gaps persist in the literature: - Overreliance on the LendingClub dataset, which limits the generalizability of findings - Limited integration of macroeconomic and behavioral data into models - Trade-offs between predictive performance and explainability - Lack of standardized evaluation metrics across studies

Objectives of the Study:

1. To categorize and analyze existing credit risk assessment models in P2P lending

2. To evaluate the comparative performance of traditional and machine learning models 3. To identify critical gaps and propose future research directions

4. METHODOLOGY

This study adopts a **Systematic Literature Review (SLR)** approach to synthesize and evaluate credit risk assessment models used in Peer-to-Peer (P2P) lending platforms. The SLR process was conducted in alignment with **PRISMA (Preferred Reporting Items for Systematic Reviews and Meta-Analyses)** guidelines to ensure rigor and transparency.

4.1 Data Sources and Search Strategy

Academic databases including **Scopus, Web of Science, IEEE Xplore, ScienceDirect, and arXiv** were systematically searched to collect relevant studies published between **January 2015 and March 2024**. The following keywords and Boolean combinations were used:

- *"Peer-to-Peer lending" OR "P2P lending" AND "credit scoring"*

- *"machine learning" OR "credit risk prediction" AND "credit risk assessment"*

4.2 Inclusion and Exclusion Criteria

- **Inclusion Criteria:**

- Peer-reviewed journal articles and conference proceedings

- Studies focusing on credit risk prediction models specifically in the P2P lending domain

- Articles written in English

- Papers that reported quantitative model performance (e.g., accuracy, AUC, F1-score)

Exclusion Criteria:

Articles that focused only on traditional banking or consumer lending without reference to P2P platforms

Non-peer-reviewed sources, whitepapers, or dissertations

Papers lacking methodological detail

4.3 Screening and Selection Process

An initial pool of **312 studies** was identified across the databases. After title and abstract screening, **154 articles** remained. Further evaluation through full-text review resulted in a final selection of **47 research papers** that met all inclusion criteria.

4.4 Data Extraction and Analysis

The selected papers were reviewed to extract information on: - Type of model used (e.g., Logistic Regression, Random Forest, XGBoost, Neural Networks)

- Data source (e.g., LendingClub, Prosper, regional P2P platforms)

- Feature engineering techniques

- Evaluation metrics (e.g., AUC, accuracy, F1-score)

- Model interpretability tools (e.g., SHAP, LIME)

- Geographical or platform-specific focus

A comparative matrix was created to evaluate model performance, interpretability, and deployment challenges. The synthesis also includes emerging trends such as hybrid models and the use of explainable AI (XAI).

5. ANALYSIS AND DISCUSSION

5.1 Model Comparison and Effectiveness

Traditional models such as Logistic Regression provide a benchmark for interpretability but fail to capture complex interactions. Machine learning models, particularly ensemble methods like XGBoost andLightGBM, outperform traditional models in terms of Area Under Curve (AUC), accuracy, and F1-score. However, their black-box nature raises questions about fairness and transparency.

5.2 Feature Engineering and Data Challenges

Effective feature engineering remains a cornerstone of high-performing models. Common features include debt-to-income ratio, loan purpose, employment status, and previous delinquencies. Advanced techniques like PCA and Recursive Feature Elimination are used to reduce dimensionality. Nonetheless, data quality and the sparsity of borrower information pose significant challenges.

5.3 Platform-Specific and Regional Variations

Most empirical studies rely on U.S.-based LendingClub or Prosper datasets. There is a noticeable gap in the study of P2P platforms in emerging markets like India (Faircent, Lendbox), China (Paipaidai), and the UK (Zopa). Regional regulatory differences and cultural factors affect borrower behavior and credit risk dynamics.

5.4 **Ethical and Regulatory Considerations**

The ethical use of AI in credit scoring includes ensuring fairness, avoiding discrimination, and maintaining data privacy. Regulatory frameworks such as GDPR (EU) and RBI guidelines (India) increasingly emphasize transparency and explainability. There is a need for model governance standards specific to P2P platforms.

6. CONCLUSION AND FUTURE DIRECTIONS

Credit risk modeling in P2P lending has evolved significantly from simplistic linear models to complex, datadriven machine learning systems. While predictive performance has improved, the trade-offs in interpretability, data availability, and ethical concerns remain critical challenges. Future work should focus on: - Developing interpretable deep learning frameworks - Incorporating real-time and macroeconomic indicators - Creating open-source, multi-country benchmark datasets - Establishing regulatory and industry standards for AI-based credit risk models

A balanced approach that combines the predictive power of AI with the transparency and fairness of traditional models is essential for sustainable and trustworthy P2P lending ecosystems.

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