Want to Loan Me Money? Here's a Picture of My Dog.

Prosper Links People Who Need Money With Those Who Have It to Lend

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A New York City social worker needs $6,800 to pay off credit card debt. A 38-year-old single mother of two living on disability and child support in Texas needs $2,000 to catch up on monthly bills. A pair of Wisconsin newlyweds need $4,000 to pay off their wedding and medical bills after the groom was treated for cancer.

But instead of going to a bank, they're asking total strangers for money. On the Internet.

Bringing together people in need of money with people who have a little to lend is the idea behind the online social lending venture called Prosper.com.

Prosper, based in San Francisco, aspires to do for money what eBay did for your grandmother's teapot collection -- create a person-to-person marketplace for consumer loans, and in the process, turn average people into bankers.

"Instead of selling your money to a bank to see the bank sell that money to someone else at 19 percent, why can't I have some of that money?" chief executive Chris Larsen said.

Prosper seeks to fill a need for small unsecured loans up to $25,000 that banks have largely abandoned or serve primarily through credit cards, which often come with complex terms and conditions that can change at any time. By contrast, all loans on Prosper last three years with a fixed interest rate and no prepayment penalties.

Banking experts have called Prosper innovative but argue its long-term viability depends on how it defends itself from fraud.

Larsen, who founded the online lender E-loan, started Prosper three years ago with $20 million from such Silicon Valley investors as Benchmark Capital and eBay founder Pierre Omidyar. Since last year when it went live, Prosper has grown to more than 140,000 members and has originated about $33 million in loans. Less than 1 percent of its loans have defaulted; close to 3 percent of its loans are at least three months late.

Prosper isn't a bank because it doesn't accept deposits. It is, however, licensed as a lender on the state level, so interest-rate limits and other state loan laws apply, said Consumer Union's Gail Hillebrand. As a lender, Prosper is also subject to federal laws like the Truth in Lending Act that require disclosure of interest rates and other terms to consumers.

Prosper verifies a potential borrower's identity using his name, address, date of birth and Social Security number. The company also pulls the applicant's credit report to create a "credit grade" ranging from AA to HR (for high risk). The grade is included in the listing, along with any state interest rate limits. Virginia borrowers, for example, can't be charged more than 12 percent interest except by a chartered bank like Citibank. Prospective lenders then bid to fund the loan.

Lenders, who can finance small pieces of many loans, get a chance to earn higher returns than they might find elsewhere, but it's not simply a numbers game. They get a borrower's story, how much money they want to borrow, the interest rate they're willing to pay, and the reason they need the money, along with monthly income and expenses. Often, pictures of borrowers, their dog or their children accompany the pitch.

Once a loan is funded, Prosper charges borrowers a 1 percent origination fee, and charges lenders an annual fee of 0.5 percent to service the loans. It automatically withdraws payments from borrowers' bank accounts and sends them to lenders. It also deals with defaults. It charges late fees. Any loans that are 30 days late go to a collection agency. Debts at least four months past due are sold to debt buyers.

Lenders are encouraged to protect themselves by lending small amounts to many borrowers with different risk levels so if one defaults, the lender is not as seriously harmed financially.

Though some borrowers pay interest rates upwards of 20 percent, the loans can still be cheaper than other forms of credit, such as a payday loan which can carry a triple-digit annual interest rate.

Some banking experts question whether 20 percent-plus rates are enough to cover a lender's risk. Bank fees may be annoying, but banks usually have a track record of managing risk, including fraud.

"When you have a brand-new ecosystem like this, you don't know how much fraud can come into play," said Jim Bruene, editor of Online Banking Report.

Prosper tries to prevent fraud by verifying the identities of both prospective borrowers and lenders. While income is self-reported, Prosper randomly verifies some figures by requesting such documentation as a pay stub and looks into other cases where the amount looks suspicious, spokeswoman Tiffany Fox said.

Prosper also relies on lenders and borrowers to spot fraud, and users freely chat about dubious listings or practices on several discussion forums.

It has not come under major assault from the types of overseas scammers that forced Paypal in its early days to freeze accounts without warning, creating a backlash among users. But banking experts predict it is only a matter of time before Prosper becomes a target and must juggle accessibility and security.

For now, borrowers can disclose as much personal information as they wish, weighing the need for privacy with the need to create a compelling pitch. Some liken the experience to online dating.

Last month, when Paul Park of Burke wanted to replace a bank loan that had a nearly 30 percent interest rate, he debated whether to include his picture with his Prosper request for nearly $5,000. Park, 26, a purchasing clerk for a local defense company, ended up posting it "because I thought it would instill more confidence in the lenders."

He was right. His loan was funded by 100 lenders at 9.75 percent interest.

Some lenders are drawn by the idea of investing in people, not impersonal corporations. Andrew Balto, owner of an IT consulting business in Columbia, said Prosper allows him to do good and do well at the same time, unlike the money he lost investing in WorldCom, the telecommunications giant that went under after a $3.8 billion accounting scandal.

"The whole corporate thing turns me off," said Balto, 39, who has lent more than $20,000. On Prosper, by contrast, "you see people getting up in the morning and trying to better themselves and their finances."

For others, it offers novelty.

Kelly Vielmo of the District has money in the stock market and real estate, but chose to lend more than $10,000 on Prosper because it was "something new and off the wall," he said.

The 30-year old business consultant and newly minted MBA has limited his exposure by lending in $50 increments. He also avoids people paying off hard-to-get-rid-of debts such as medical bills and payday loans. He's been averaging a return of 12.2 percent and has had no defaults or late payments. But he also expects he will have his share of defaults and accepts the risk. "I'm early in my career in trying to make a buck," he said.