
REGULATORY EXPERIMENTATION IN CHINA’S PEER-TO-
PEER LENDING MARKET

Zhou Qin*

Xiao Shanyun**

Table of Contents

I.INTRODUCTION	60
II.THEORY OF REGULATORY EXPERIMENTATION.....	63
A. Overview of Regulatory Experimentation.....	63
B. Application of Regulatory Experimentation to China’s Financial Innovation	65
III.REGULATORY EXPERIMENTATION IN CHINA’S P2P LENDING MARKET ..	68
A. Overview of China’s P2P Lending Market	68
B. Phase One: The “Unregulated” Period (Before 2015)	70
C. Phase Two: The “Adaptive Regulation” Period (2015 to 2017) .	71
1. Registration and Recordation.....	72
2. Third-party Custodians.	73
3. Information Disclosure.....	75
D. Phase Three: The “Aggressive Regulation” Period (After 2017)	78
1. Governance Arrangements	78
2. Special Enforcement Plans	79
IV.REGULATORY EXPERIMENTATION UNDER HIERARCHY: THE KEY MOTIVATIONS AND THE UNINTENDED CONSEQUENCES.....	81
A. The Identification of Regulated Objects.....	81
B. The Change of Regulatory Objective	83
C. The Central-Local Relationship.....	84
D. Unintended Consequences	85
V.CONCLUSION.....	87

* Zhou Qin, Assistant Professor, Macau University of Science and Technology, Faculty of Law. Email: zhouqin@must.edu.mo.

** Xiao Shanyun, Senior Lecturer, Hong Kong Metropolitan University, Lee Shau Kee School of Business and Administration. Email: syxiao@hkmu.edu.hk.

REGULATORY EXPERIMENTATION IN CHINA'S PEER-TO-PEER LENDING MARKET

Zhou Qin

Xiao Shanyun

Abstract

The dramatic ups and downs of China's peer-to-peer (P2P) lending market have attracted global attention. Most discussion revolves around the necessity and appropriateness of China's regulation of the P2P market. However, the logic behind the changes of the regulation has not been fully discovered. This article aims to fill this gap by applying regulatory experimentation theory to interpret the process of regulating the P2P lending market in China. It first overviews the development of China's P2P lending market by identifying two market milestones. It then divides regulatory experimentation on China's P2P lending market into three phases—the “unregulated” period (before 2015), “adaptive regulation” period (2015-2017), and “aggressive regulation” period (after 2017) —based on the regulatory approaches adopted by Chinese regulators. This article finds that regulators gradually shifted from relying on “substantive” regulatory tools to “procedural” ones. It argues that the changes in the regulatory approaches of P2P lending are thought to reflect the trade-off between protecting the economic interests brought by financial innovation and protecting the social stability.

I. INTRODUCTION

Small and medium-sized enterprises (SMEs), as a type of private business association, occupy an essential part of the market economy with Chinese characteristics.¹ Constrained by limited collaterals and a lack of reliable track records, SMEs often encounter bottlenecks in their development—they struggle to obtain low-cost capital or funding from traditional banking institutions.² To control the rate of nonperforming loans, traditional banking institutions have long leaned on the thresholds for loans and granted loans to borrowers with higher credit ratings and sufficient collaterals.³ Therefore, the gap in meeting the adequate financing needs of SMEs was widening as most

¹ Xiangfeng Liu, *SME Development in China: A Policy Perspective on SME Industrial Clustering*, in *SME IN ASIA AND GLOBALIZATION* 37, 37–68 (Hank Lin ed., 2008), http://www.eria.org/SME%20Development%20in%20China_A%20Policy%20Perspective%20on%20SME%20Industrial%20Clustering.pdf (last visited Feb. 14, 2020).

² See Ding Lu, Shandre M. Thangavelu & Qing Hu, *Biased Lending and Non-Performing Loans in China's Bank Sector*, 41 *J. DEV. STUD.* 1071, 1091 (2005); see also Sandra Poncet, Walter Steingress & Hylke Vandenbussche, *Financial Constraints in China: Firm-level evidence*, 21 *CHINA ECON. REV.* 411, 422 (2010).

³ Terence Tai-Leung Chong, Liping Lu & Steven Ongena, *Does Banking Competition Alleviate or Worsen Credit Constraints Faced By Small- and Medium-Sized Enterprises? Evidence From China*, 37 *J. BANKING & FIN.* 3412, 3424 (2013).

SMEs have limited financing options and often tend to borrow from loan sharks.⁴ With the rise of financial technology (FinTech), however, the situation has reversed dramatically: online P2P lending has brought numerous funding opportunities to companies or individuals with limited credit but urgent financing needs therein. As of 2021, nearly 18.8 percent of the Chinese netizens managed their wealth online, which provided potential funding opportunities for SMEs.⁵

Online P2P lending refers to the direct lending between individuals through internet platforms.⁶ This financial innovation directly connects creditors and borrowers through a data-based matching system, which reduces information asymmetry.⁷ The opening of online P2P lending is a breakthrough in China's lending market, as it lowers the bar for engaging in lending activities and allows private lending to make up for the shortage and scarcity of public goods. Unlike traditional commercial banks, which impose strict lending requirements on SMEs, online P2P lending maximizes the use of digital shadow economy, and takes advantage of the supervision loophole in qualification examinations and granting approvals.⁸ The online P2P lending is expected to provide another means for SMEs and individuals to overcome financing difficulties and promote economic growth.⁹ As a result, China's online P2P lending market has experienced rapid expansion since 2011, with thousands of P2P platforms starting to conduct loan matching.¹⁰ In 2017, the annual trading volume of P2P platforms peaked at RMB 2.8 trillion.¹¹

However, neither the market participants nor the government could thoroughly understand the possible risks that online P2P lending can bring to the nascent industry. The insufficiency of comprehensive regulation could bog down market participants since the concealment and the virtual nature of online P2P lending makes it a hotbed of misbehavior. Many P2P platforms have been

⁴ Huidan Lin, *Foreign Bank Entry and Firms' Access to Bank Credit: Evidence from China*, 35 J. BANKING & FIN. 1000, 1010 (2011).

⁵ China Internet Network Information Center, *The 49th Statistical Report on China's Internet Development* 26, 27 (2022), <http://www.cnnic.com.cn/IDR/ReportDownloads/202204/P020220424336135612575.pdf> (last visited June 23, 2022).

⁶ Guanyu Cujin Hulianwang Jinrong Jiankang Fazhan de Zhidao Yijian (关于促进互联网金融健康发展的指导意见) [Guiding Opinions on Promoting the Sound Development of Internet Finance] (jointly promulgated by the People's Bank of China, et al., July 14, 2015, effective July 14, 2015) art. 8 (Chinalawinfo) (hereinafter *2015 Guiding Opinions*).

⁷ Jiaqi Yan, Wayne Yu & J. Leon Zhao, *How Signaling and Search Costs Affect Information Asymmetry in P2P Lending: the Economics of Big Data*, 1 FIN. INNOVATION 1, 1–19 (2015).

⁸ Ligita Gasparėnienė, Rita Remeikienė & Friedrich Georg Schneider, *Concept, Motives and Channels of Digital Shadow Economy: Consumers' Attitude*, 18 J. BUS. ECON. MGMT. 273, 287 (2017).

⁹ Meghana Ayyagari, Asli Demirgüç-Kunt & Vojislav Maksimovic, *Formal versus Informal Finance: Evidence from China*, 23 REV. FIN. STUD. 3048, 3097 (2010).

¹⁰ SHANGHAI FINANCE INSTITUTE P2P RESEARCH GROUP, PEER-TO-PEER LENDING WITH CHINESE CHARACTERISTICS: DEVELOPMENT, REGULATION AND OUTLOOK 16 (2016).

¹¹ The data was collected and calculated by authors from www.wdzj.com. (link no longer accessible since the website has been closed due to the closure of all P2P lending platforms)

involved in illegal activities and transactions, such as financial fraud or abuse of users' information privacy, placing users' rights and interests at risk.¹² For example, *Ezubao* (e租宝) and *Zibang Jinfu* (资邦金服) had been involved in financial fraud. They maliciously defrauded the investors and then escaped with the stolen money, bringing massive losses to the platform investors.¹³ Therefore, the regulation of P2P lending is extremely urgent.

Since FinTech innovation is new to the financial market, China has limited regulatory experience to draw on. Given the *sui generis* context of the Chinese financial market, financial regulators have faced a "regulatory dilemma" between the normalization of the online P2P lending market and the rapid economic growth.¹⁴ In order to establish a sustainable P2P lending market, Chinese regulators have gradually taken a proactive regulatory approach. They have incorporated scholars' policy recommendations in adjusting institutional design and building a regulatory framework for P2P lending.¹⁵ To mitigate risks, they have also adopted specific regulatory measures such as registration and recordation, third-party custodians, and information disclosure.¹⁶ Although a proactive regulatory approach can accelerate the discovery of the fraudulent P2P companies so that an orderly P2P lending market can be established, it may also increase the instability of P2P lending market because creditors may concern about the safety of their investments and demand borrowers or P2Ps to pay back their investments, leading to a cash shortage within legitimate online P2P lending companies. A sensible regulatory approach is not to search for a "cure-all" regulation but to "pursue a new governance institution which accommodates never-ending recursive feedback loops between market practice and regulation".¹⁷

¹² Cheng Leng & Brenda Goh, *China Probes P2P Lender Over 'Intimidation' as Crackdown Widens*, REUTERS (Oct. 22, 2019, 2:33 PM), <https://www.reuters.com/article/China-p2p-51-credit-card/China-probes-p2p-lender-overintimidation-as-crackdown-widens-idUSL3N2770HI> (last visited Jan. 16, 2021).

¹³ Neil Gough, *Online Lender Ezubao Took \$7.6 Billion in Ponzi Scheme, China Says*, N.Y. TIMES (Feb. 1, 2016), <https://www.nytimes.com/2016/02/02/business/dealbook/ezubao-china-fraud.html> (last visited Feb. 17, 2020); Han Yi & Leng Cheng, *Another Online Lender Falls Under Investigation*, CAI XIN GLOBAL (June 28, 2018, 8:01 PM), <https://www.caixinglobal.com/2018-06-29/another-online-lender-falls-under-investigation-101288658.html> (last visited Feb. 17, 2020).

¹⁴ Emiliios Avgouleas & Duoqi Xu, *Overhauling China's Financial Stability Regulation: Policy Riddles and Regulatory Dilemmas*, 4 ASIAN J. L. & SOC'Y 1, 17-20 (2017).

¹⁵ See, e.g., Shen Wei, *Internet Lending in China: Status Quo, Potential Risks and Regulatory Options*, 31 COMPUT. L. & SEC. REV. 793, 805 (2015); Weihuan Zhou, Douglas W. Arner & Ross P. Buckley, *Regulation of Digital Financial Services in China: Last Mover Advantage*, 8 TSINGHUA CHINA L. REV. 25, 27-28 (2015); Jingyi Wang, Yan Shen & Yiping Huang, *Evaluating the Regulatory Scheme for Internet Finance in China: The Case of Peer-to-Peer Lending*, 9 CHINA ECON. J. 272, 282-283 (2016).

¹⁶ JIAZHOU G. WANG & JUAN YANG, FINANCING WITHOUT BANK LOANS: NEW ALTERNATIVES FOR FUNDING SMES IN CHINA 71-72 (2016); Xue Lei, *Discussion of the Risks and Risk Control of P2P in China*, 7 MOD. ECON. 399, 402 (2016).

¹⁷ Xiao Li & Iain MacNeil, *Experimentation in Securities Market Structure and Regulation in China: From State to Market*, 16 J. CORP. L. STUD. 241, 242 (2016).

Existing literature has mainly focused on discussing China's overall regulatory regime on P2P lending, only a few studies have tried to interpret the logics of the changes in China's P2P lending regulation.¹⁸ This article adopts the regulatory experimentation theory to analyze the Chinese government's dynamic process of choosing different regulatory instruments to govern its online P2P lending market, as well as the positive and negative effects of the regulatory regime's transformation. It divides the regulatory experimentation on China's P2P lending market into three phases based on the regulatory approaches adopted by Chinese regulators, and analyzes different types of regulatory tools adopted in different phases. Hence, this article helps readers understand the technique of adjusting regulatory rules for China's online P2P lending market. In addition, as a driving force of financial innovation, innovative financial technologies, such as P2P lending, have disrupted the traditional financial markets and exposed loopholes in existing financial regulations and policies. An in-depth analysis of the regulatory tools and their adjustment in response to innovative financial technologies would also help readers understand the logic of regulating innovative technologies more broadly in China.

The article is structured as follows: Part II reviews the literature on regulatory experimentation and proposes an analytical framework. Part III illustrates the three phases of the experimentation on China's P2P lending and regulation with a focal point on analyzing different types of regulatory tools adopted in each phase. Part IV discusses the drives and unintended consequences of the experimentation on China's P2P lending market. Part V concludes.

II. THEORY OF REGULATORY EXPERIMENTATION

A. Overview of Regulatory Experimentation

Regulatory experimentation is a popular regulatory model widely adopted in developed countries.¹⁹ Although policymakers have conducted experimentation in many regulatory areas, there is still a lack of a clear and unified definition of regulatory experimentation.²⁰ The terminologies used to describe the notion for experimenting with regulation include "policy experimentation", "sandboxes", "real-world laboratories", "regulatory

¹⁸ See, e.g., Chang-hsien Tsai, *To Regulate or Not to Regulate: A Comparison of Government Responses to Peer-to-Peer Lending among the United States, China, and Taiwan*, 87 U. CIN. L. REV. 1077, 1093–1097 (2018); Tao Yu & Wei Shen, *Funds Sharing Regulation in the Context of the Sharing Economy: Understanding the Logic of China's P2P Lending Regulation*, 35 COMPUT. L. & SEC. REV. 42, 43–49 (2019); SARA HSU & JIANJUN LI, *CHINA'S FINTECH EXPLOSION: DISRUPTION, INNOVATION, AND SURVIVAL* 66–88 (2020).

¹⁹ Dierk Bauknecht et al., *Exploring the Pathways: Regulatory Experiments for Sustainable Development—An Interdisciplinary Approach*, 9 J GOVERNANCE & REGUL. 49, 49–50 (2020).

²⁰ *Id.*

innovation zones”, and “regulatory experimentation”.²¹ Some scholars have attempted to classify different regulatory experimentation types based on the explicit hypothesis that policymakers want to test and the specific methods they use to complete the test.²² Others have tried to seek similarities between regulatory experimentation types and have produced several variables that can be used to analyze any regulatory experimentation. Bauknecht and his co-authors have found four core features of regulatory experiments, including “(1) clear hypothesis, (2) interaction between actors, (3) causality, and (4) monitoring and learning”.²³ McCray and others have concluded that regulatory experimentation (as they term “planned adaptation” in regulation) usually proceeded in two phases: “identification of plausible examples” and “evaluation of candidate cases for relevance”.²⁴

Regulatory experimentation often comes with disruptive innovation, which has been considered “a key part of effective competition”.²⁵ Policymakers can generate regulatory learning through experiments and choose appropriate regulatory approaches when facing complicated innovations with uncertain outcomes.²⁶ There are generally two patterns of regulatory experimentation, with one focused on designing new rules and the other on adjusting existing rules. The first one is to start with “experimental pilot/project” and then incorporate the successful experience into national regulations.²⁷ The second one is the “regulatory sandbox”, which allows innovators (i.e., the financial innovators) and authorities (i.e., the financial regulators) to experiment with new products and services where regulatory requirements will be tightened or relaxed on a case-by-case basis.²⁸

²¹ *Id.* at 54–55.

²² See Jens Ludwig, Jeffrey R. Kling & Sendhil Mullainathan, *Mechanism Experiments and Policy Evaluations*, 25 J. ECON. PERSP. 17, 30-31 (2011); Belinda McFadgen & Dave Huitema, *Experimentation at the Interface of Science and Policy: A Multi-Case Analysis of How Policy Experiments Influence Political Decision-Makers*, 51 POL’Y SCI. 161, 165-167 (2018).

²³ Bauknecht et al., *supra* note 19, at 55.

²⁴ Lawrence E. McCray, Kenneth A. Oye & Arthur C. Petersen, *Planned Adaptation in Risk Regulation: An Initial Survey of US Environmental, Health, and Safety Regulation*, 77 TECH. FORECASTING & SOC. CHANGE 951, 952 (2010).

²⁵ *Regulatory Sandbox*, FINANCIAL CONDUCT AUTHORITY (FCA) (November, 2015), <https://www.fca.org.uk/publication/research/regulatory-sandbox.pdf> (last visited Sept. 22, 2020) [hereinafter FCA].

²⁶ Claudio M. Radaelli, *Measuring Policy Learning: Regulatory Impact Assessment in Europe*, 16 J. EUR. PUB. POL’Y 1145, 1147-1152 (2009); Michael Greenstone, *Toward a Culture of Persistent Regulatory Experimentation and Evaluation*, NEW PERSPECTIVE ON REGULATION 111, 126 (David A. Moss & John A. Cisternino eds., 2009).

²⁷ Bauknecht et al., *supra* note 19, at 56; Dave Huitema, Andrew Jordan, Stefania Munaretto & Mikael Hildén, *Policy Experimentation: Core Concepts, Political Dynamics, Governance and Impacts*, 51 POL’Y SCI. 143 (2018).

²⁸ Lin Lin, *Regulating FinTech: The Case of Singapore*, 35 BANKING & FIN. L. REV. 93, 97-100 (2019); Christopher C. Chen, *Rethinking the Regulatory Sandbox for Financial Innovation: An Assessment of the UK and Singapore*, REGULATING FINTECH IN ASIA 11, 30 (Mark Fenwick, Van Uytsel & Steven Bi Ying eds., 2020).

The popularity of regulatory experimentation stems from its relatively low costs of practice (e.g., low risk to actors, inexpensive to use, inclusiveness).²⁹ However, there are some concerns about the costs associated with regulatory experimentation. Such expenses include limitations of options,³⁰ lack of transparency in the experimental process,³¹ and increasing social costs.³² Hence, scholars have suggested that cost-benefit analysis should be adopted when conducting regulatory experiments.³³

B. Application of Regulatory Experimentation to China's Financial Innovation

Chinese policymakers should be familiar with experimentation in policymaking. Many studies have shown the importance of experimentation in the policymaking process of China's central government.³⁴ While there is rich literature on the contribution of experimentation to the economic development in China, few studies have paid attention to the regulatory experimentation in China's financial markets.³⁵ But as some scholars have put it, "[g]iven that China has been enjoying the benefits arising from experimentation with economic development policies, it is not surprising that experimentation on the regulation [...] has also been attempted."³⁶

The regulatory experimentation carried out in China is different from that in the West. Such a difference is mainly reflected in the purpose of adopting experimentation and the existence of corresponding laws at the beginning of experimentation. In the West, experimentation is used to relax the onerous compliance requirements to improve innovation and adapt to relevant regulations.³⁷ In other words, experimentation operates under the shadow of the law. In China, by contrast, experimentation begins without a corresponding legal framework.³⁸ Regulatory policymakers develop rules through experimentation.³⁹ In addition, given the hierarchical administrative system

²⁹ See Cass Sunstein, *Empirically Informed Regulation*, 78 U. CHI. L. REV. 1349, 1365-1366 (2011); Greenstone, *supra* note 26.

³⁰ FCA, *supra* note 25, at 19-20.

³¹ Chen, *supra* note 28, at 18.

³² David C. Donald, *Hong Kong's Fintech Automation: Economic Benefits and Social Risks*, in *REGULATING FINTECH IN ASIA 1*, 50 (Mark Fenwick, Van Uytsel & Steven Bi Ying eds., 2020).

³³ Eric A. Posner & E. Glen Weyl, *Benefit-Cost Paradigms in Financial Regulation*, 43 J. LEGAL STUD. S1 (2014); Matthew Spitzer & Eric Talley, *On Experimentation and Real Options in Financial Regulation*, 43 J. LEGAL STUD. S121 (2014).

³⁴ See generally LOCAL GOVERNANCE INNOVATION IN CHINA: EXPERIMENTATION, DIFFUSION, AND DEFIANCE (Jessica C. Teets & William Hurst eds., 2014).

³⁵ See generally THE OXFORD HANDBOOK OF GOVERNANCE (David Levi-Faur ed., 2012).

³⁶ Li & MacNeil, *supra* note 17, at 243.

³⁷ See generally JOWELL ROGER, TRYING IT OUT: THE ROLE OF 'PILOTS' IN POLICY-MAKING (2003).

³⁸ Charles F. Sabel & Jonathan Zeitlin, *Experimentalist Governance*, in THE OXFORD HANDBOOK OF GOVERNANCE, *supra* note 35, at 169, 186.

³⁹ Sebastian Heilmann, *Experimentation under Hierarchy: Policy Experiments in the Reorganization of China's State Sector, 1978-2008*, 172 CENTER FOR INTERNATIONAL DEVELOPMENT AT HARVARD UNIVERSITY WORKING PAPERS (2008), <https://www.hks.harvard.edu/sites/default/files/centers/cid/files/>

with strong central control, China's regulatory experimentation is under hierarchy.⁴⁰ This means "the traditional technique of developing regulatory rules (in the West) through market failure and cost-benefit analysis could not be applied since there was no market in place and therefore no concept of market failure."⁴¹ Regarding regulating FinTech innovation in China, some scholars have proposed learning from the western regulatory sandbox experiences to establish a controllable experimental scenario for the cultivation and growth of financial innovation.⁴² Others have argued that China does not need to follow the global FinTech regulatory fashion, because China has already been pushing regulatory experimentation, the essence of regulatory sandbox experiences, across the nation.⁴³ Before implementing a comprehensive regulatory system, China embraces a laissez-faire approach to regulating FinTech, thus allowing market participants to experiment without immediately facing repercussions from the regulator.⁴⁴

Similar to their counterparties, Chinese regulators must balance the "economic interests of agents that drive these innovations with those of citizens and members of societies that are affected by the outcomes of these innovations."⁴⁵ To achieve such a balance, they need to experiment with different types of regulatory tools and carefully assemble them into a "toolbox".⁴⁶ Typically, there are two broad categories of regulatory tools: "substantive" tools, such as mandated requirements or prescriptions; and "procedural" tools, which refer to continuous administrative processes.⁴⁷ Regulators have to continuously experiment with and adjust regulatory tools to market developments.⁴⁸ The suitability of regulatory tools, therefore, impacts the degree to which regulatory objectives can be accomplished.

The literature offers an opportunity to structure an analytical framework for this article.⁴⁹ It postulates that China's regulation on financial innovation has

publications/faculty-working-papers/172.pdf (last visited Sept. 22, 2020).

⁴⁰ *Id.*

⁴¹ Li & MacNeil, *supra* note 17, at 243.

⁴² Lev Bromberg, Andrew Godwin & Ian Ramsay, *Fintech Sandboxes: Achieving a Balance Between Regulation and Innovation*, 28 J. BANKING & FIN. L. & PRAC. 314, 336 (2017).

⁴³ Fan Liao, *Does China Need the Regulatory Sandbox? A Preliminary Analysis of Its Desirability as an Appropriate Mechanism for Regulating Fintech in China*, in REGULATING FINTECH IN ASIA 81, 95 (Mark Fenwick, Van Uytsel & Steven Bi Ying eds., 2020).

⁴⁴ Dirk A. Zetzsche, Ross P. Buckley, Douglas W. Arner & Janos N. Barberis, *Regulating a Revolution: From Regulatory Sandboxes to Smart Regulation*, 23 FORDHAM J. CORP. & FIN. L. 50, 51 (2017).

⁴⁵ Araz Taeihagh, M. Ramesh & Michael Howlett, *Assessing the Regulatory Challenges of Emerging Disruptive Technologies*, 15 REGUL. & GOVERNANCE 1009, 1011 (2021).

⁴⁶ There are other expressions similar to "toolbox", such as "mix", "portfolio" or "package". *Id.* at 1012.

⁴⁷ *Id.*

⁴⁸ Bernstein postulated the "regulatory life cycle theory", suggesting that regulatory development go through four recognizable stages: gestation, youth, maturity and old age. See MARVER H. BERNSTEIN, REGULATING BUSINESS BY INDEPENDENT COMMISSION (1955).

⁴⁹ Douglas W. Arner and his co-authors' observation on different regulatory approaches to FinTech innovation: "doing nothing", "flexibility and forbearance", "restricted experimentation" and "regulatory

roughly gone through three distinct phases: lax regulation, adaptive regulation, and aggressive regulation (see Table 1). In each phase, the regulators' objectives and their choices of regulatory tools are associated with the impact and outcomes of financial innovation. More specifically, Chinese regulators tend to be modest in the early stages of financial innovation, but become more cautious about the negative impact once they recognize its destructive nature. Chinese regulators have experimented different kinds of "substantive" regulatory tools, aiming at mitigating the negative impact of financial innovation. However, when such a regulatory objective fails to be achieved, Chinese regulators have aggressively implemented "procedural" regulatory tools such as clean-up and rectification. The following parts will apply the proposed typology to illustrate China's online P2P lending market's dynamic regulatory experimentation with the focal point of accessing regulatory tools in different phases.

TABLE 1. REGULATING FINANCIAL INNOVATION IN CHINA: A TYPOLOGY

	Phase One (lax regulation)	Phase Two (adaptive regulation)	Phase Three (aggressive regulation)
Financial Innovation	An emerging market with small trading volumes; Small and medium-sized enterprises; Nonprofessional enterprises provide unlicensed services; The risks are small and not fully identified.	A rapidly expanding market has seen a surge in trading volumes; Medium and large-sized enterprises join in the market; A growing number of enterprises provide licensed services; The increasing risk has become a hidden danger affecting the economy and society.	The market is shrinking fast, and trading volumes are plunging; Medium and large-sized enterprises dominate the market; A majority of enterprises are professional and provide licensed services; Systemic risks are gradually emerging.
Regulatory Responses	Promoting innovation; Trying to understand the innovation; Identifying the risks.	Concerning innovation; Warning of the risks; Designing rules to regulate market innovation and control risks.	Cleaning up the mess caused by innovation; Prioritizing risk control; Tightening the rules and strengthening enforcement.
Regulatory Tools	Insufficient regulatory tools	Designing different types of regulatory	Relying more on "procedural" tools

development". See Douglas W. Arner, Dirk A. Zetsche, Ross P. Buckley & Janos N. Barberis, *FinTech and RegTech: Enabling Innovation While Preserving Financial Stability*, 18 GEO. J. INT'L AFF. 47, 58 (2017).

	(“substantive” and “procedural”).	tools, Relying more on “substantive” tools.	
--	-----------------------------------	---	--

III. REGULATORY EXPERIMENTATION IN CHINA’S P2P LENDING MARKET

China’s P2P lending market has undergone dramatic changes over the past decade. The main reason, as many scholars have argued, is that China’s regulation of the P2P lending market has shifted from a light-touch approach to a heavy-handed approach.⁵⁰ This article reinforces existing conclusions by adding some empirical findings, links China’s P2P lending market practice and corresponding regulation, and argues that the ups and downs of the market are the result of regulators’ changing regulatory purposes and their experimentation with different regulatory tools. This section first briefly introduces the life cycle of China’s P2P lending market with a focal point on the two milestones. The following sections then connects the evolution of the P2P lending market with the processes of regulatory experimentation, and divides the processes into three phases: the “lax regulation” period (before 2015), the “adaptive regulation” period (2015-2017), and the “aggressive regulation” (after 2017). Particular attention has been paid to the regulatory tools adopted by Chinese regulators at different phases, as per the regulatory measures and attitudes derived from the regulatory documents shown in Appendix.

A. Overview of China’s P2P Lending Market

China’s P2P lending market emerged in approximately 2006 and has experienced rapid development over the past decade.⁵¹ While this article generally agrees with the previous observation of China’s P2P lending market development, it argues that a more accurate description can be formed by combining the number of platforms, trading volume and outstanding loans. Figure 1 presents the number of P2P lending platforms and their transaction records. According to the apparent changes in 2015 and 2017, this article divides the market development into three periods: rapid expansion before 2015, adjustment between 2015 and 2017, and recession after 2017.

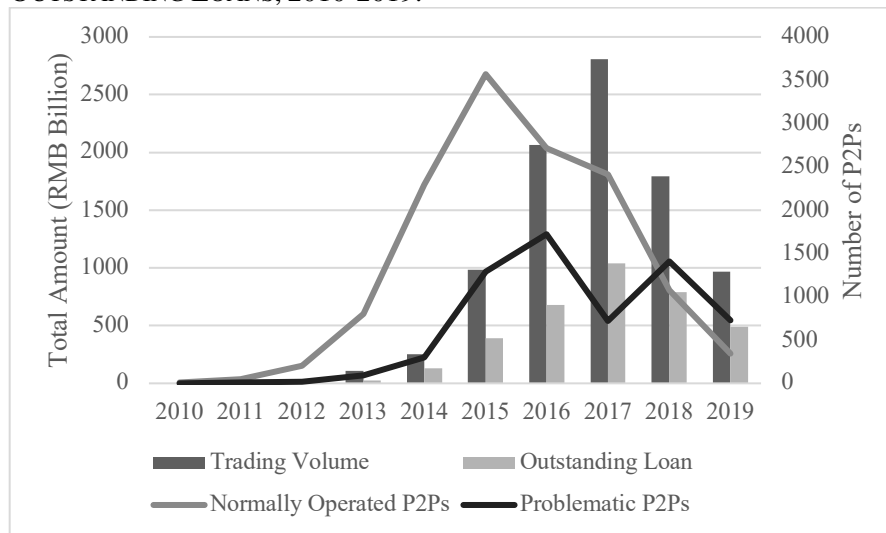
Before 2015, the number of functioning P2P platforms surged from 10 in 2010 to 3570 in 2015, and their yearly trading volume reached RMB 982.3 billion. Between 2015 and 2017, while the number of functioning P2P

⁵⁰ See Yu & Shen, *supra* note 18; Robin Hui Huang, *Online P2P Lending and Regulatory Responses in China: Opportunities and Challenges*, 19 EUR. BUS. ORG. L. REV. 63, 92 (2018); Chuanman You, *Recent Development of FinTech Regulation in China: A Focus on the New Regulatory Regime for the P2P Lending (Loan-based Crowdfunding) Market*, 13 CAP. MARK. L. J. 85, 115 (2018).

⁵¹ Scholars have different views about the launching of the first online P2P lending platforms in China. Huang Hui argues that CreditEase.cn (Yi Xin) was the first online P2P lending platform in China, established in 2006. See Huang, *supra* note 50, at 65; You Chuanman argues that PPDai.com (Pai Pai Dai) was the first one though it was launched in 2007. See You, *supra* note 50, at 89.

platforms began to drop, both the trading volume and outstanding loans continued to grow until reaching the peak of RMB 2.8 trillion (for trading volume) and RMB 1.04 trillion (for outstanding loans) in 2017. After 2017, the P2P lending market shrank quickly. With problematic P2P platforms continuing to be detected and shut down, the number of functioning platforms dropped to 344 at the end of 2019. The P2P lending market also became less active as the annual trading volume fell by two-thirds compared to the peak in 2017. Meanwhile, outstanding loans dropped to RMB 491.59 billion in 2019, less than half of the peak (RMB 1.04 trillion) in 2017.

FIGURE 1. ANNUAL NUMBER OF P2P PLATFORMS, TRADING VOLUME AND OUTSTANDING LOANS, 2010-2019.



Source: data collected and calculated by authors from www.wdzj.com.

This article also argues that the remarkable turning points in 2015 and 2017 are connected to the changes in regulation of the P2P lending market. While the market's rapid expansion was driven by a "high online penetration", "large supply of funds", and "unmet financial demands",⁵² it should not be denied that the P2P lending market enjoyed a "golden time" when Chinese regulators held favorable attitudes toward P2P lending and took a laissez-faire approach toward this market.⁵³ However, P2Ps' misconduct has aroused public concern, putting pressure on Chinese regulators to set thresholds for online lending market and requirements to manage the P2P lending business.⁵⁴ From 2015 to 2017, Chinese regulators experimented with different types of regulatory tools to

⁵² Huang, *supra* note 50, at 66–67.

⁵³ Yu & Shen, *supra* note 18, at 49–50.

⁵⁴ Shen, *supra* note 15.

normalize the P2P lending market, such as recordation and administration, mandatory disclosure, and third-party custodians. The effectiveness of these regulatory instruments was not satisfactory because outstanding loans continued to increase during this period, which raised the central government's concern about the systemic financial risk. After 2017, Chinese regulators started to lay a heavy hand on P2Ps, shifting from enhanced enforcement to aggressive regulation.

Based on the above description of the P2P market development and the corresponding regulatory changes, this article divides China's P2P regulation process into three phases: the "unregulated" period (before 2015), the "adaptive regulation" period (2015-2017), and the "aggressive regulation" period (after 2017). At each phase, Chinese regulators experimented with different types of regulatory tools and strategies, which will be analyzed in detail in the following sections.

B. Phase One: The "Unregulated" Period (Before 2015)

China's financial market has long been known for being strictly regulated with market entry permission and massive requirements. Thus, it is puzzling to witness that P2Ps had not been subject to any financial-related rules and regulations since their emergence before 2015. This article explains that such a puzzle was caused by regulators' tendency to experiment with new financing models to supplement the conventional bank-based financing model. Regulators had objectives during this phase: cultivating the P2P lending market, identifying the role of P2Ps in the financial market, and observing the potential risks caused by the uncontrolled growth of P2Ps.

The first objective was to foster a P2P lending market. As Figure 1 shows, the market was inactive before 2013. In 2012, there were approximately 200 platforms with a trading volume of RMB 21.2 billion. The market welcomed a large number of participants, particularly on the supply side, when the central government cleared the air to promote Internet finance innovation and standardize Internet financial services.⁵⁵ The number of functioning platforms jumped to 2293 as of 2014, but their annual trading volume remained relatively small (RMB 252.8 billion in 2014) (see Figure 1 above). One possible reason for such a phenomenon was that lenders were concerned about the risks of investing through P2Ps because a majority of platforms at that time had small capitalization, with registered capital between RMB 5 million and RMB 20 million.⁵⁶

The second objective was to recognize the potential risk of P2P lending and its influence on the financial market. Chinese regulators held an optimistic

⁵⁵ See Guanyu Cujin Xinxi Xiaofei Kuoda Neixu de Ruogan Yijian (关于促进信息消费扩大内需的若干意见) [Several Opinions on Promoting Information Consumption and Boosting Domestic Demand] (promulgated by the St. Council, Aug. 8, 2013, effective Aug. 8, 2013) ST. COUNCIL GAZ., Aug. 30, 2013, Part VI (China).

⁵⁶ Shen, *supra* note 15, at 800.

attitude toward P2Ps because they believed that the benefits outweighed the costs. On the one hand, P2Ps have been perceived as a way to facilitate financial inclusiveness because these platforms offer opportunities for unbanked or underbanked individuals to participate in the lending market.⁵⁷ On the other hand, P2Ps offered individuals and SMEs that had difficulties accessing the conventional banking sector an alternative channel to raise capital, which had been considered helpful in boosting the real economy.⁵⁸ Therefore, even though Chinese regulators were aware of the risks of P2P lending, they appeared to prioritize financial innovation at the cost of arising issues in financial consumer and retail investor protection.⁵⁹

The third objective was to understand the role of P2P in the financial market. It is important to understand the nature of P2Ps and their business models because these factors influence regulators' choice of regulatory approaches.⁶⁰ P2Ps were supposed to be different from conventional commercial lenders because they provided credit-related information and credit risk assessments rather than credit itself. However, there were variants of the information intermediary model. P2Ps acted more like financial institutions that pooled deposits or investments and lent them to borrowers, or they lent through their own capital.⁶¹ The variant P2Ps posed a conundrum to Chinese regulators, as they have to balance the trade-off between underregulation (allowing potential credit risks to increase) and overregulation (deviating from the central policy to promote financial innovation).

In short, the experimentation at this stage was to understand the P2P lending market. Regulators had taken an off-hand approach to let the market develop, understand the nature of P2Ps and their variants, and observe the potential risks imposed by P2Ps on the financial market.

C. Phase Two: The "Adaptive Regulation" Period (2015 to 2017)

From 2015 to 2017, the rapid expansion of China's P2P lending market demonstrated two trends: a downward trend in the number of platforms and an upward trend in trading volume and outstanding loans.⁶² This article argues that such trends were the result of regulatory responses. Chinese regulators recognized the issues in the P2P lending market and began to establish a new regulatory regime in response. This section focuses on analyzing three

⁵⁷ Guanyu Cujin Hulanwang Jinrong Jiankang Fazhan de Zhidao Yijian (关于促进互联网金融健康发展的指导意见) [Guiding Opinions on Promoting the Sound Development of Internet Finance] (jointly promulgated by the People's Bank of China, et al., July 14, 2015, effective July 14, 2015) art. 1 (Chinalawinfo).

⁵⁸ See Tuijin Puhui Jinrong Fazhan Guihua (2016–2020) (推进普惠金融发展规划 (2016–2020年)) [Plan for Advancing the Development of Inclusive Finance (2016–2020)] (issued by the St. Council, Dec. 31, 2015, effective Dec. 31, 2015) (Chinalawinfo).

⁵⁹ Shen, *supra* note 15, at 800–802.

⁶⁰ William S. Warren, *The Frontiers of Peer-to-Peer Lending: Thinking About a New Regulatory Approach*, 14 DUKE L. & TECH. REV. 298 (2016).

⁶¹ Huang, *supra* note 50, at 70–71.

⁶² See Part A of Section III for a more detailed illustration.

“substantive” regulatory tools that Chinese regulators had experimented during this period: registration and recordation, third-party custodians, and information disclosure.

1. Registration and Recordation. The first “substantive” regulatory tool is registration and recordation. The requirements for registration and recordation were first stipulated in the *Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Institutions* (hereinafter *2016 Interim Measures*)⁶³ and refined through the *Guidelines for the Administration of Recordation and Registration of P2P Lending Information Intermediary Institutions* (hereinafter *2016 Guidelines*).⁶⁴ As required, a P2P must complete a recordation and registration procedure that involves three different regulatory authorities before operating the business. A P2P must first obtain a usual business license from the company registry, then conduct recordation and registration with the local financial regulator, and finally obtain a telecommunication business license from the telecommunication administrative department.⁶⁵

Some scholars argue that at least two reasons explain why such a three-step procedure represents “a light-touch regulatory approach” for establishing online lending information intermediaries.⁶⁶ First, it does not set special requirements for establishing online lending information intermediaries. The relevant rules only mention the required supporting documents for recordation and registration and the duration for processing these materials but do not prescribe any threshold such as registered capital.⁶⁷ Second, it does not require approval from the local financial regulator. The relevant rules make it clear that “recordation does not constitute the recognition and evaluation of the management capability, degree of compliance, or credit status of an online lending information intermediary.”⁶⁸

⁶³ Wangluo Jiedai Xinx Zhongjie Yewu Huodong Guanli Zanxing Banfa (网络借贷信息中介机构业务活动管理暂行办法) [Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Institutions] (jointly promulgated by China Banking Regul. Comm., et al., Aug. 17, 2016, effective Aug. 17, 2016) (Chinalawinfo).

⁶⁴ Wangluo Jiedai Xinx Zhongjie Jigou Beian Dengji Guanli Zhiyin (网络借贷信息中介机构备案登记管理指引) [Guidelines for the Administration of Recordation and Registration of P2P Lending Information Intermediary Institutions] (promulgated by China Banking Regul. Comm., et al., Oct. 28, 2016, effective Oct. 28, 2016) (Chinalawinfo).

⁶⁵ Wangluo Jiedai Xinx Zhongjie Yewu Huodong Guanli Zanxing Banfa (网络借贷信息中介机构业务活动管理暂行办法) [Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Institutions] (jointly promulgated by China Banking Regul. Comm., et al., Aug. 17, 2016, effective Aug. 17, 2016), art 5 (Chinalawinfo).

⁶⁶ Huang, *supra* note 50, at 73.

⁶⁷ *Id.*

⁶⁸ Wangluo Jiedai Xinx Zhongjie Yewu Huodong Guanli Zanxing Banfa (网络借贷信息中介机构业务活动管理暂行办法) [Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Institutions] (jointly promulgated by the China Banking Regul. Comm., et al., Aug. 17, 2016, effective Aug. 17, 2016), art 5(2) (Chinalawinfo); Wangluo Jiedai Xinx Zhongjie Jigou Beian Dengji Guanli Zhiyin (网络借贷信息中介机构备案登记管理指引) [Guidelines for the Administration of

However, we argue that the three-step procedure actually acts as a threshold for establishing online lending information intermediaries. First, some local financial regulators set specific requirements for establishing online lending information intermediaries in their regions. For example, Guangdong Province has issued consultation papers on the registration matter, whereas platforms are encouraged, albeit not needed, to pay up registered capital of RMB 50 million or above.⁶⁹ Platforms are also required to submit additional materials, such as credit reports of the main promoter and top three shareholders, a letter of good conduct if the main promoter and the top three shareholders are natural persons, and the law firm's legal opinion on recordation and registration.⁷⁰

Second, the registration and recordation involves a substantive review of the application materials. Submitting relevant supporting materials as required by the platform only means that the registration and recordation with the local financial regulator has been initiated. This does not mean that the platform can be registered successfully.⁷¹ The local financial regulator shall take necessary measures to review the application materials substantively. These measures include online verification, on-site inspection, and interviews with executives.⁷² Thus, the local financial regulator can refuse the registration and recordation of the platform after conducting a substantive review of its application materials. The result of the substantive review is critical because successful registration and recordation is a prerequisite for the platform to apply for the telecommunication business license. Those who cannot obtain the telecommunication business license must not carry out an online lending information intermediary business.⁷³

2. Third-party Custodians. The second "substantive" regulatory tool is third-party custodians. The 2015-2016 Chinese stock market turbulence exposed many P2P lending problems and legal risks, including some large-

Recordation and Registration of P2P Lending Information Intermediary Institutions] (promulgated by China Banking Regul. Comm., et al., Oct. 28, 2016, effective Oct. 28, 2016), art 2(2) (Chinalawinfo).

⁶⁹ Guangdongsheng Wangluo Jiedai Xinxu Zhongjie Jigou Beian Dengji Guanli Shishi Xize (广东省网络借贷信息中介机构备案登记管理实施细则 (征求意见稿)) [Guangdong Province Implementing Rules on the Administration of Recordation and Registration of Online Lending Information Intermediary Institutions] (promulgated by Fin. Work Office Guangdong Province, Feb. 14, 2017), art. 6 (China).

⁷⁰ *Id.* art. 8.

⁷¹ Huang, *supra* note 50, at 73.

⁷² Wangluo Jiedai Xinxu Zhongjie Jigou Beian Dengji Guanli Zhiyin (网络借贷信息中介机构备案登记管理指引) [Guidelines for the Administration of Recordation and Registration of P2P Lending Information Intermediary Institutions] (promulgated by China Banking Regul. Comm., et al., Oct. 28, 2016, effective Oct. 28, 2016) art. 8 (Chinalawinfo).

⁷³ Wangluo Jiedai Xinxu Zhongjie Yewu Huodong Guanli Zanxing Banfa (网络借贷信息中介机构业务活动管理暂行办法) [Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Institutions] (jointly promulgated by the China Banking Regul. Comm., et al., Aug. 17, 2016, effective Aug. 17, 2016) art. 5(4) (Chinalawinfo).

scale “Ponzi schemes”.⁷⁴ Thousands of P2P platforms have been detected to be involved in illegal fundraising and illegal deposit-taking after local financial regulators carried out special rectification plans.⁷⁵ The requirement of third-party custodians is designed to address the issue of platforms’ illegal use of lenders’ and borrowers’ funds. According to Article 28 of the *2016 Interim Measures*, a platform is required to manage its own funds and the funds of lenders and borrowers separately and select a qualified banking financial institution as the custodian of the funds of lenders and borrowers.⁷⁶ However, since the concept of a qualified banking financial institution was not clarified in the *2016 Interim Measures*, this regulatory tool did not work well in the early implementation. Platforms often use a model known as “joint custodian”, where banks and third-party payment companies jointly hold lenders’ and borrowers’ funds in custody, to avoid the monitoring of their fund management.⁷⁷ In response to the above-mentioned problems, the China Banking Regulatory Commission (CBRC) issued a special guideline on the custodian business for online lending funds in 2017, limiting the types of banking financial institutions to qualified commercial banks.⁷⁸

The effect of the bank custodian is twofold. On the one hand, it reduces the possibility of platforms using lenders’ and borrowers’ funds. Commercial banks should review the background of platforms when receiving platforms’ applications for custodian services.⁷⁹ Even though the requirements and procedures for review are not clearly defined, commercial banks have been prudent about platforms’ applications for custodians. Only a small number of platforms had successfully signed contracts with commercial banks for fund custodian service.⁸⁰ If a commercial bank decides to provide custodian service for a platform, it must open a special account for lenders’ and borrowers’ funds that is independent from the account for the platform’s self-owned fund. The bank shall open subaccounts for lenders, borrowers, and guarantors under the special account.⁸¹ It can set up instruction verification methods when lenders or borrowers instruct the bank to process transactions after loan matching

⁷⁴ Jinglin Jiang, Li Liao, Zhengwei Wang & Xiaoyan Zhang, *Government Affiliation and Peer-to-Peer Lending Platforms in China* (May 20, 2019), <https://ssrn.com/abstract=3116516> (last visited Sept. 23, 2020); Gough, *supra* note 13.

⁷⁵ See Hulianwang Jinrong Fengxian Zhuanxiang Zhengzhi Gongzuo Shishi Fangan (互联网金融风险专项整治工作实施方案) [Implementation Plan for Special Rectification on Risks in Internet Finance] (promulgated by the St. Council, Apr. 12, 2016, effective Apr. 12, 2016) (Chinalawinfo).

⁷⁶ *Id.* art. 28.

⁷⁷ See ROBIN HUI HUANG, *FINTECH REGULATION IN CHINA: PRINCIPLES, POLICIES AND PRACTICES* 14–51 (2021).

⁷⁸ Wangluo Jiedai Zijin Cungan Yewu Zhiyin (网络借贷资金存管业务指引) [Guidelines for the Online Lending Fund Depository Business] (promulgated by the China Banking Regul. Comm., Feb. 22, 2017, effective Feb. 22, 2017), art 2 (Chinalawinfo) (hereinafter *2017 Guidelines*).

⁷⁹ *Id.* art. 12(1).

⁸⁰ For example, in Zhejiang province, only 110 out of 793 platforms ever had bank custodian service as of 2019. Unpublished data in author’s hands.

⁸¹ *2017 Guidelines, supra* note 78, art. 12(2).

through the platform.⁸² The bank can record platform users' information, including their transaction information and other necessary information, and cross-check with the daily transaction data submitted by the platform.⁸³

On the other hand, the risk of online lending is de facto transferred to custodian banks. Custodian service is attractive to commercial banks, especially small and medium-sized banks.⁸⁴ This is because the fee-based custodian service was perceived to bring considerable benefits to these banks without risks. According to the guidelines, custodian banks neither provide guarantees to online lending nor assume liability for loan default through P2Ps.⁸⁵ However, the P2P fund custodian service actually brings risks to banks in two aspects. First, it increases the custodian bank's reputational risk. Even though a P2P is prohibited from using the name of the custodian bank for marketing promotions, it often places the bank's name in a prominent position on the grounds of fulfilling the information disclosure obligation.⁸⁶ Although custodian banks are eager to distance themselves from P2Ps, the disclosures can make it easy for lenders to believe that their lending will be free from risk because the custodian bank will endorse the platform.⁸⁷ Second, the explosion of P2Ps increases the liquidity risk of custodian banks. Most P2P lending is for consumption purposes, which means borrowers use P2P loans for daily living expenses or small-scale production. The custodian service is supposed to be easy and straightforward because banks are only responsible for transferring money among P2P's special account and borrowers' and lenders' subaccounts. However, in reality, the balance of P2P's special account is often close to zero. Thus, commercial banks gradually ceased to provide custodian services for P2Ps.⁸⁸

3. Information Disclosure. The third "substantive" regulatory tool is the mandatory information disclosure regime. The mysteriously high return rate for P2P lending has attracted millions of lenders,⁸⁹ which generated considerable risk management burden for P2Ps since they were responsible for monitoring borrowers' credit worthiness to safeguard lenders' money. To

⁸² *Id.* art. 12(3).

⁸³ *Id.* art. 12(4) and (5).

⁸⁴ Wu Yujian (吴雨俭), *Zhongxiao Yinhang Qiangtan P2P Cunguan, Dahang Taidu Jinshen* (中小银行抢滩P2P存管, 大行态度谨慎) [*Small and Medium-sized Banks Rush to Custodian Services for P2Ps, and Big Banks Are Cautious*], CAIXIN (Mar. 19, 2017, 3:07 PM), <https://finance.caixin.com/2017-03-19/101067691.html> (last visited June 2, 2022).

⁸⁵ 2017 *Guidelines*, *supra* note 78, art. 2.

⁸⁶ *Id.* art. 21.

⁸⁷ Liu Shuangxia (刘双霞), *P2P Pin Baolei, Cungan Yinhang Qiu "Yinshen"* (P2P频爆雷, 存管银行求"隐身") [*Frequent Explosions of P2Ps, Custodian Banks Seek "to Be Invisible"*], People.cn (Sep. 26, 2017, 7:49 AM), <http://money.people.com.cn/n1/2017/0926/c42877-29558698.html> (last visited June 3, 2022).

⁸⁸ Li Bin (李冰), *Yinhang Chonggu Wangdai Cungan Yewu Xinjiabi, Bajia Yinhang Anxia "Xiuzhijian"* (银行重估网贷存管业务性价比, 8家银行按下"休止键") [*Banks Reassess the Cost-Effectiveness of Custodian Service for Online Lending, Eight Banks "Press the Stop Button"*], People.cn (Jul. 5, 2019, 8:31 AM), <http://money.people.com.cn/n1/2019/0705/c42877-31215484.html> (last visited June 3, 2022).

⁸⁹ See You, *supra* note 50, at 91.

monitor operational risks, P2Ps are required to disclose two types of information: platform-related information and project-related information.⁹⁰ The former includes registration and recordation information and information revealing the overall condition of the P2P loan-matching service.⁹¹ The latter includes information that describes the borrower, the project and the risk evaluation.⁹² Any information disclosed must be reliable, accurate, complete and timely.⁹³

Three mechanisms have been established to ensure the transparency of P2P lending. These include introducing market intermediaries as gatekeepers, submitting information disclosure reports to relevant authorities, and establishing personal responsibility for directors, supervisors and senior executives.⁹⁴ However, selective implementation of information disclosure has raised concerns about the efficiency of these mechanisms. In practice, P2Ps rarely disclose information that reflects the operational condition of themselves, such as annual accounting reports, annual auditing reports, overstay rates and outstanding loan rates.⁹⁵ In addition, P2Ps generally do not disclose a borrower's creditworthiness and repayment ability, a project's credit score, and the progress of fund operation.⁹⁶ Such problems can be explained by the lack of credit evaluation standards for borrowers' creditworthiness, the lack of a mechanism to incentivize P2Ps to disclose information, and the lack of an accountability mechanism to bind P2Ps and their leadership for information disclosure obligations.⁹⁷

To conclude, the "one plus three" regulatory regime (refers to one Interim Measures plus three Guidelines)⁹⁸ has been established during this period, which implements three "substantive" regulatory tools so that the exposure of problematic P2Ps would ensure the safety and soundness of the P2P lending market. As shown in Figure 2, the total number of P2Ps stopped its sharp

⁹⁰ Wangluo Jiedai Xinxin Zhongjie Jigou Yewu Huodong Xinxin Pilu Zhiyin (网络借贷信息中介机构业务活动信息披露指引) [Guidelines for the Disclosure of Information on the Business Activities of Online Lending Information Intermediary Institutions] (promulgated by the CBRC, Aug. 23, 2017, effective Aug. 23, 2017), ch. 2 (Chinalawinfo).

⁹¹ *Id.* arts. 7 and 8.

⁹² *Id.* art. 9.

⁹³ *Id.* art. 5.

⁹⁴ 2016 *Interim Measures*, *supra* note 63, art. 31.

⁹⁵ See Jing Wang et al. (汪静等), *P2P Wangdai Pingtai Xinxin Pilu Shuiping, Touziren Xinren yu Touzi Fengxian* (P2P网贷平台信息披露水平、投资人信任与投资风险) [*Peer-to-Peer Lending Platforms' Disclosure, Investors' Trust, and Investment Risk*], 3 *ZHONGGUO JINGJI WENTI* (中国经济问题) [CHINA ECON. STUD.] 106, 111–112 (2018).

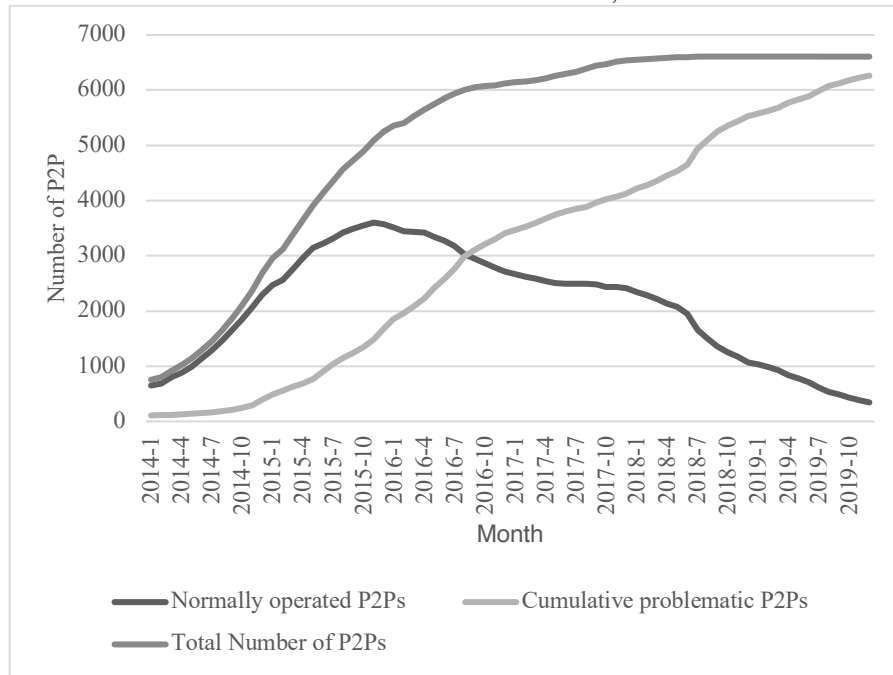
⁹⁶ *Id.*

⁹⁷ See Qing He & Xiaoyang Li, *The Failure of Chinese Peer-to-Peer Lending Platforms: Finance and Politics*, 66 *J. CORP. FINANCE* 1 (2021).

⁹⁸ One Interim Measures refers to the Interim Measures for Administration of the Business Activities of Online Lending Information Intermediary Institutions; three Guidelines refers to Guidelines for the Administration of Recordation and Registration of P2P Lending Information Intermediary Institutions, Guidelines for the Online Lending Fund Depository Business, and Guidelines for the Disclosure of Information on the Business Activities of Online Lending Information Intermediary Institutions.

increase and remained flat since the regulators implemented “substantive” regulatory tools. The number of functioning P2Ps declined because many platforms failed to evaluate and monitor borrowers’ creditworthiness and repayment ability and got stuck with outstanding loans.⁹⁹ These platforms were ordered to rectify, cease operations, suspend or close their business, resulting in an increase in the number of problematic P2Ps. Although the number of functioning P2P platforms began dropping since 2015, the trading volume increased sharply in the following two years, indicating that China’s P2P lending market was still expanding.¹⁰⁰ The increasing amount of outstanding loans created by problematic P2P platforms has worried policymakers because of possible systemic financial risks and potential social instability.¹⁰¹

FIGURE 2. MONTHLY NUMBER OF P2P PLATFORMS, 2014-2019.



Source: data collected and calculated by authors from www.wdzj.com.

⁹⁹ Xie Yu, *China's Central Bank Orders Crackdown on Online Lenders to Curb Runaway Credit*, SOUTH CHINA MORNING POST (Nov. 22, 2017, 8:00 AM), <https://www.scmp.com/business/banking-finance/article/2120972/chinas-central-bank-issues-orders-rein-peer-peer-lenders>.

¹⁰⁰ The monthly trade volume reached its peak of RMB 253.68 billion (about \$36.23 billion) in July 2017; and the cumulative debts stopped its rapid growth in October 2017, reaching RMB 1034.56 billion (about \$147.76 billion). Data collected and calculated by authors from www.wdzj.com.

¹⁰¹ Shen, *supra* note 15.

D. Phase Three: The “Aggressive Regulation” Period (After 2017)

The massive scandals of P2P schemes did not deter retail investors from investing in P2P lending businesses to pursue high returns. The yearly trading volume continued to grow until it peaked at RMB 2.8 trillion in 2017. Meanwhile, the outstanding loans increased to RMB 1.04 trillion.¹⁰² Policymakers became increasingly concerned about the repayments of outstanding loans and the systemic financial risks caused by loan defaults, which would cause social and financial instability.¹⁰³ To improve the effectiveness of the above-mentioned “substantive” regulatory tools, the Chinese central government also adopts “procedural” regulatory tools such as “governance arrangements” and “special rectification plans”. This section analyzes these “procedural” regulatory tools.

1. Governance Arrangements. Even though the “one plus three” regulatory regime is generally sound, its efficacy in building a healthy and orderly P2P lending market is questionable.¹⁰⁴ On the one hand, the regulations lack deterrence. According to the *2016 Interim Measures*, financial regulators can issue a warning letter, an order of correction or a fine up to RMB 30,000 (approximately USD 4,398) if a P2P platform violates relevant provisions.¹⁰⁵ Such penalties were too weak for P2P platforms, especially when their infractions could generate huge profits. Second, the fragmented regulatory structure of the financial market became an obstacle difficult to overcome for effective supervision.¹⁰⁶

The administration of P2P lending involves multiple local government departments. These include, at a minimum, the local company registry, the local telecommunication administrative department, and the local financial regulator. Multidepartmental joint administration requires an effective communication mechanism to reduce the administrative cost caused by sharing information and coordinating administration. Therefore, a special multi-ministry task force entitled “the Leading Group for the Special Campaign against P2P Lending Risks” was established to facilitate the implementation of the guiding opinions regarding P2P administration and supervision.¹⁰⁷

¹⁰² The data was collected and calculated by authors from www.wdzj.com.

¹⁰³ See Zhang Shu & Elias Glenn, *Beijing Struggles to Defuse Anger Over China’s P2P Lending Crisis*, REUTERS (Aug. 12, 2018, 3:02 PM), <https://www.reuters.com/article/us-china-lenders-p2p-insight-idUSKBN1KX077>.

¹⁰⁴ See Huang, *supra* note 50; Yu & Shen, *supra* note 18.

¹⁰⁵ Wangluo Jiedai Xinxi Zhongjie Jigou Yewu Huodong Guanli Zanxing Banfa (网络借贷信息中介机构业务活动管理暂行办法) [Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Institutions] (jointly promulgated by the CBRC, et al., Aug. 17, 2016, effective Aug. 17, 2016) art. 40 (Chinalawinfo).

¹⁰⁶ See You, *supra* note 50, at 98.

¹⁰⁷ Hulianwang Jinrong Fengxian Zhuanxiang Zhengzhi Gongzuo Shishi Fangan (互联网金融风险专项整治工作实施方案) [Implementation Plan for Special Rectification on Risks in Internet Finance] (promulgated by the St. Council, Apr. 12, 2016, effective Apr. 12, 2016) Part IV (Chinalawinfo).

People's Bank of China (PBOC) led the task force to foster national rectification plans against P2P platforms' problematic and noncompliance behavior.¹⁰⁸ Provincial governments are requested to establish a local task force to design and implement local ratification plans against problematic P2Ps. These local task forces were dictated to complete specific regulatory tasks within a limited time and report their regulatory result to the central task force.¹⁰⁹

2. Special Enforcement Plans. The task force then led the rectification of the P2P lending market. It first suspended the approval of small-sized online loan companies and internet microfinance companies¹¹⁰ and specified the P2P platforms' business rules based on the types of loans they offer. For example, a notice was issued to regulate the "cash loan" business conducted by P2P platforms. The notice requires P2P platforms to manage their funding sources cautiously and disallow them from raising funds, engaging in any illegal fundraising activities or absorbing public deposits.¹¹¹ The notice also stresses that individuals and institutions who conduct unlicensed online moneylending must be severely punished.¹¹²

Then, the task force established a "checklist" to unify the standards for clearing up problematic P2P platforms.¹¹³ The previous two rounds of special investigation and rectification campaigns were led by local authorities, relying on the self-inspection of the P2P lending industry. Although the campaigns accomplished the goal of identifying and rectifying problematic P2P platforms, some issues were still left exposed, such as inconsistent investigation and

¹⁰⁸ Guanyu Yinfa Tongguo Hulianwang Kaizhan Zichan Guanli ji Kuajie Congshi Jinrong Yewu Fengxian Zhuanxiang Zhengzhi Gongzuo Shishi Fangan de Tongzhi (关于印发《通过互联网开展资产管理及跨界从事金融业务风险专项整治工作实施方案》的通知) [Notice on Issuing the Implementation Plan for the Special Rectification of Risks in Conducting Asset Management through the Internet and Engaging in Financial Business in a Crossover Manner] (jointly promulgated by the PBOC, et al., Apr. 14, 2016, effective Apr. 14, 2016) (Chinalawinfo).

¹⁰⁹ Guanyu Zuohao P2P Wangluo Jiedai Fengxian Zhuanxiang Zhengzhi Zhenggai Yanshou Gongzuo de Tongzhi (关于做好P2P网络借贷风险专项整治整改验收工作的通知) [Notice on Carrying Out Work on Special Rectification and Acceptance of Online P2P Lending Risks] (issued by the Office of the Leading Group for the Special Campaign against P2P Lending Risks, Dec. 8, 2017, effective Dec. 8, 2017) (Chinalawinfo).

¹¹⁰ Guanyu Liji Zanting Pishu Wangluo Xiaoe Daikuan Gongsu de Tongzhi (关于立即暂停批设网络小额贷款公司的通知) [Notice on Immediate Suspension of Licenses for Internet Microfinance Companies] (issued by the Office of the Leading Group for the Special Campaign against Internet Financial Risks, Nov. 21, 2017, effective Nov. 21, 2017) (Lawyee) (China).

¹¹¹ Guanyu Zhengdun "Xianjindai" Yewu de Tongzhi (关于规范整顿"现金贷"业务的通告) [Notice on the Regulation and Rectification of the "Cash Loan" Business] (issued by the Office of the Leading Group for the Special Campaign against Internet Financial Risks & the Office of the Leading Group for the Special Campaign against P2P Lending Risks, Dec. 1, 2017, effective Dec. 1, 2017) (Chinalawinfo).

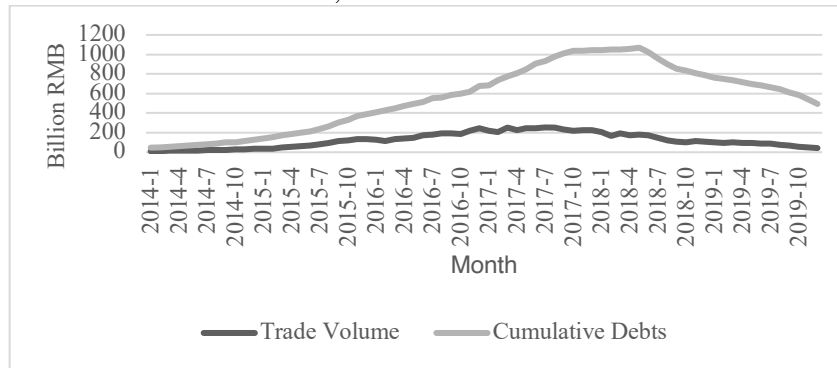
¹¹² *Id.*

¹¹³ The checklist contains 108 items. See Guanyu Kaizhan P2P Wangluo Jiedai Jigou Hegui Jiancha Gongzuo de Tongzhi (关于开展P2P网络借贷机构合规检查工作的通知) [Notice on Compliance Inspection of Online P2P Lending Intermediary] (issued by the Office of the Leading Group for the Special Campaign against P2P Lending Risks, Aug. 17, 2018, effective Aug. 17, 2018) (Lawyee) (China).

rectification standards and notoriously opaque processes.¹¹⁴ In August 2018, the task force issued the Compliance Inspection of Online P2P Lending Intermediary (hereinafter *2018 Compliance Inspection*) to facilitate the nationwide clean-up of problematic P2P platforms.¹¹⁵ The “checklist” summarizes the problems that have led to the growing number of outstanding loans. It consists of 108 items that can be divided into ten categories, including whether the platform (1) serves as an information intermediary; (2) holds a money pool; (3) conducts self-financing; (4) directly or indirectly guarantees lenders with the return of capital and interest; (5) practices rigid redemption; (6) conducts risk assessment on lenders; (7) fully discloses borrowers’ information to lenders; (8) adheres to the small loan requirements; (9) sells wealth management products; and (10) attracts lenders or investors with high inducements.

Enforcing the “checklist” directly impacts the trading volume and outstanding loans through P2P platforms. As shown in Figure 3, trading volume remained steady until the issuance of the checklist in mid-2018, after which it started dropping. The P2P lending market risks became apparent as the cumulative outstanding loans increased drastically to nearly RMB 1 trillion in the middle of 2017 and remained unchanged for a year until its quick drop starting from mid-2018. Starting in the middle of 2018, both the monthly trading volume and cumulative outstanding loans dropped quickly.

FIGURE 3. MONTHLY TRADING VOLUME AND OUTSTANDING LOANS THROUGH P2P PLATFORMS, 2014-2019.



¹¹⁴ Zheng Yang, director of the Shanghai Financial Affairs Office, said to a news report, “the same business, the same organization, the standards should be uniform, the rules should be transparent.” See Song Jie (宋杰), *P2P Youxian Jizhong “Baolei”, huo Jingli Jianguan Zhengzhiqi “Zhentong”* (P2P又现集中“爆雷”, 或经历监管整治期“阵痛”)[*P2P Lending Bubble Burst, Experiencing Pains during the Purge*], CHINA ECONOMIC WEEKLY (July 23, 2018, 9:58 AM), <http://www.ceweekly.cn/2018/0723/229986.shtml> (last visited Dec. 4, 2022).

¹¹⁵ Guanyu Kaizhan P2P Wangluo Jiedai Jigou Hegui Jiancha Gongzuo de Tongzhi (关于开展P2P网络借贷机构合规检查工作的通知) [Notice on Compliance Inspection of Online P2P Lending Intermediary] (issued by the Office of the Leading Group for the Special Campaign against P2P Lending Risks, Aug. 17, 2018, effective Aug. 17, 2018) (Lawyer) (China).

Source: data collected and calculated by authors from www.wdzj.com.

The P2P platforms experienced “breathless moments” as the regulation became aggressive. Most platforms could not meet strict compliance requirements and had to terminate their business.¹¹⁶ Even those who have complied with the regulatory requirements and operated well have been forced to clear their outstanding loans.¹¹⁷ While outstanding loans dropped quickly during this period, aggressive regulation perhaps ended China’s P2P lending market.¹¹⁸

IV. REGULATORY EXPERIMENTATION UNDER HIERARCHY: THE KEY MOTIVATIONS AND THE UNINTENDED CONSEQUENCES

The disruptive nature of FinTech has challenged financial regulators across jurisdictions.¹¹⁹ They have to “balance the traditional regulatory objectives of financial stability and consumer protection—the focus of post-crisis regulatory changes—with the objectives of promoting growth and innovation.”¹²⁰ China’s experimentation in P2P lending and regulation reveals how Chinese authorities perceive financial innovation in the private sector and its role in the national economic and social development plan. This part argues that three key elements are manifested to drive the swift changes in China’s approaches to regulating P2P lending: the identification of the regulated object, the evolution of the regulatory objective, and the central-local relationship. It further argues that a balance should be driven when managing these elements; otherwise, there could be unintended consequences through regulatory experimentation.

A. *The Identification of Regulated Objects*

The way a country regulates P2P lending platforms is determined by lawmakers’ or policymakers’ understanding of such platforms. For example, when regulating P2P lending, the US takes a security-based regulatory approach because P2Ps are treated as security issuers, and the UK takes a

¹¹⁶ As of August 2020, only 29 out of more than 6,000 P2Ps remained in operation. See Daniel Ren, *China’s Financial Clean-up Whittles Thousands of Peer-to-Peer Lenders Down to Just 29, with US\$115 Billion in Outstanding Debt*, SOUTH CHINA MORNING POST (Aug. 14, 2020, 9:00 PM), <https://www.scmp.com/business/banking-finance/article/3097445/chinas-top-banking-regulator-vows-track-down-errant-p2p> (last visited Dec. 4, 2022).

¹¹⁷ Leng Cheng & Engen Tham, *China Gives P2P Lenders Two Years to Exit Industry*, REUTERS (Nov. 28, 2019, 9:26 AM), <https://www.reuters.com/article/us-china-p2p-idUSKBN1Y2039> (last visited Dec. 4, 2022).

¹¹⁸ While a Central-bank official, in the 2020 Singapore FinTech Festival, said that “by mid-November the actual operating P2P lenders had all been zeroed out”, the author checked approximately 200 Chinese P2Ps’ websites in January and February of 2021, and found that some of them are still operating. See Chong Koh Ping & Yu Xie, *China Hails Victory in Crackdown on Peer-to-Peer Lending*, WALL ST. J. (Dec. 9, 2020, 7:05 AM), <https://www.wsj.com/articles/china-hails-victory-in-crackdown-on-peer-to-peer-lending-11607515547?tesla=y> (last visited Dec. 4, 2022).

¹¹⁹ See Tacihagh et al., *supra* note 45.

¹²⁰ See Arner et al., *supra* note 49, at 48.

banking regulatory approach because P2Ps provide many services similar to banks.¹²¹

In China, the essence of P2P platforms was debated before its legal definition was prescribed in 2016. P2P Platforms were considered as “quasi-financial institutions”, “credit servicers”, or “financial service providers”.¹²² The legal definition of P2P platforms is prescribed in the *2016 Interim Measures*. Accordingly, P2P platforms are identified as “information intermediaries”, providing credit-related information services that facilitate loan matching.¹²³ They are prohibited from conducting deposit-taking business or providing credit enhancement services.¹²⁴ Such a definition is critical for regulating P2Ps in China. This legal definition indicates that Chinese regulators intend to separate P2Ps from financial institutions, which helps resolve the dilemma that P2Ps are not subject to China’s Commercial Bank Law and Securities Law due to their legal nature. It also lays the foundation for establishing the “one plus three” regime for P2P platforms.¹²⁵

However, the regulations and their enforcement reveal that Chinese regulators still consider that platforms should be regulated as financial institutions per se. As mentioned above, provincial regulators encourage P2P platforms to meet registered capital requirements, a prudential regulation commonly used to govern financial institutions.¹²⁶ This tendency became more pronounced during the aggressive regulation stage, when the provincial governments and regulators were ordered to implement special rectification plans. According to the task force’s opinion, provincial regulators should actively guide functioning P2Ps to transform into online small loan companies or licensed asset management companies.¹²⁷ As of June 2021, only a few P2P lending platforms have been successfully transferred into online small loan companies.¹²⁸

¹²¹ See Warren, *supra* note 60.

¹²² See Shen, *supra* note 15, at 802–803; Huang, *supra* note 50, at 70–71.

¹²³ Wangluo Jiedai Xinxi Zhongjie Jigou Yewu Huodong Guanli Zanzing Banfa (网络借贷信息中介机构业务活动管理暂行办法) [Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Institutions] (jointly promulgated by the CBRC, et al., Aug. 17, 2016, effective Aug. 17, 2016) art. 2 (Chinalawinfo).

¹²⁴ *Id.* art. 3.

¹²⁵ Yu & Shen, *supra* note 18, at 50.

¹²⁶ See Part C in Section III for a detailed discussion.

¹²⁷ Guanyu Zuohao Wangdai Jigou Fenlei Chuzhi he Fengxian Fangfan Gongzuo de Yijian (关于做好网贷机构分类处置和风险防范工作的意见) [Opinions on Classified Disposal and Risk Prevention of Online Lending Intermediary Institutions] (issued by the Office of the Leading Group for the Special Campaign against Internet Financial Risks & the Office of the Leading Group for the Special Campaign against P2P Lending Risks, Dec. 19, 2018, effective Dec. 19, 2018) (Lawyer) (China).

¹²⁸ See You Miao (游淼), *Xiaoyingkeji Qixia Xiaodai Gongsi Wancheng Gongshang Dengji* (小赢科技旗下小贷公司完成工商登记) [*The Small Loan Company Owned by X Financial Has Completed Registration*], SINA (June 2, 2021, 6:24 PM), <https://finance.sina.com.cn/chanjing/gsnews/2021-06-02/doc-ikqczyi7345773.shtml> (last visited Dec. 4, 2022).

B. *The Change of Regulatory Objective*

Another element that affects regulators' choices of approaches to governing P2P lending is the objective of the regulation. On the one hand, regulators may adopt a laissez-faire approach to govern disruptive technologies aiming at promoting financial innovation that could facilitate economic growth. On the other hand, regulators may choose to aggressively intervene in the development of technologies if all ramifications of technology deployment negatively impact society at large.¹²⁹ Such explanations of the changes in regulatory approaches also apply to P2P lending regulation in China.

China's P2P lending market started approximately in 2006. The large population of Internet and mobile users was the P2P lending market's foundation.¹³⁰ As an innovative financing tool, P2P lending has been welcomed by lenders and borrowers because it satisfies both financial needs. P2Ps also provide some benefits that fit into the country's overall economic development blueprint. For example, they have promoted financial inclusiveness by reaching out to unbanked or underbanked individuals; and also boosted the real economy by offering comparatively inexpensive capital to SMEs. Therefore, even though P2P lending raised concerns about the protection of financial consumers and retail investors,¹³¹ China's regulators seemed to be tolerant of the potential risks brought by P2Ps because they weighted the benefits of developing the P2P lending market over the costs.¹³²

P2P platforms' non-compliance behavior not only caused significant monetary losses to hundreds of thousands of small lenders and retail investors,¹³³ but also resulted in more serious social problems such as suicide and prostitution.¹³⁴ However, the increasing amount of outstanding loans alerted Chinese regulators to be serious about regulating the P2P lending market, which was inundated with many platform-related issues.¹³⁵ As of

¹²⁹ See Taihagh et al., *supra* note 45, at 1011.

¹³⁰ The population of net citizens increased from 110 million in 2005 to 648.75 million in 2014. See China Internet Network Information Center, *The 35th Statistical Report on China's Internet Development* 1, 25 (2015), <http://www.cnnic.com.cn/IDR/ReportDownloads/201507/P020150720486421654597.pdf> (last visited Dec. 4, 2022).

¹³¹ See Shen, *supra* note 15, at 800–802.

¹³² For a detailed illustration of local innovation and governance in China, see generally Teets & Hurst, *supra* note 34.

¹³³ It is estimated that China's problematic P2P platforms caused US\$115 billion in losses. See Charliz Zhu, Jun Luo & Zheng Li, *China's Peer-to-Peer Lending Purge Leaves \$115 Billion in Losses*, BLOOMBERG (Aug. 14, 2020, 2:00 PM), <https://www.bloomberg.com/news/articles/2020-08-14/china-s-peer-to-peer-lending-purge-leaves-115-billion-in-losses>.

¹³⁴ See Zhang Shu & Ryan Woo, *After Spate of Suicides, China Targets Predatory Student Lending*, REUTERS (Sept. 27, 2017, 7:20 AM), <https://www.reuters.com/article/us-china-debt-campus-insight-idUSKCN1C13BO>.

¹³⁵ Yu & Shen, *supra* note 18, at 49–50.

2017, P2P lending created outstanding loans of 1.27 percent of the GDP.¹³⁶ The increasing amount of outstanding loans posed a threat to financial sustainability. Hence, the regulatory objective shifted from promoting financial innovation to reducing outstanding loans. China's regulators have also adopted new tools, such as third-party custodians, information disclosure and special enforcement plans, to facilitate the regulatory objective of reducing outstanding loans.

C. *The Central-Local Relationship*

The central-local relationship is the third element that could influence changes in the regulatory approach. In regulating P2P lending, provincial governments play an important role. They were ordered to detect P2Ps' undesirable behavior and reported such information to the central government to design effective rules.¹³⁷ They detected four major "off-the-screen" activities conducted by P2P platforms, namely, "campus loan (校园贷)", "naked loan (裸贷)", "trap loan (套路贷)", and "cash loan (现金贷)". Campus loan refers to platforms offering loans to university and college students with a lower or even no threshold for obtaining loans, usually without collateral.¹³⁸ Naked loan refers to platforms that mainly target female borrowers, taking nude selfies or videos of borrowers, and subsequently threatening to expose such footage if borrowers fail to repay loans.¹³⁹ Trap loans related platforms mainly target vulnerable groups (i.e., elders and teenagers). They trap borrowers into a credit-debtor relationship by cheating (i.e., malicious creation of debts, fake litigation and arbitration) or violence.¹⁴⁰ Cash loans refer to platforms that do not have a particular targeted group of borrowers yet provide loans in cash without verifying borrowers' credit status and the purpose of loans.¹⁴¹ Some common problems were also found among different types of platforms. These include insufficient registered capital, unlicensed loan-matching services, cash pooling and usury.

¹³⁶ The amount of outstanding loan in China's P2P lending market reached RMB 1.04 trillion at the end of 2017, while the GDP of 2017 was RMB 82.08 trillion. The data was collected and calculated by authors from the website of the National Bureau of Statistics.

¹³⁷ This stage is also called "detecting". For a detailed discussion, see generally ROBERT BALDWIN, MARTIN CAVE & MARTIN LODGE, *UNDERSTANDING REGULATION: THEORY, STRATEGY, AND PRACTICE* 227-258 (2nd ed. 2012).

¹³⁸ See Wang Shujun, *Students, Beware of Loan Sharks on Campus*, CHINA DAILY (Sept. 3, 2018, 7:05 AM), <https://global.chinadaily.com.cn/a/201809/03/WS5b8c6cc0a310add14f3891e6.html> (last visited Feb. 16, 2020).

¹³⁹ See Stuart Leavenworth, *China's "Naked Loans" Force Female Students to Bare All in Return for More Cash*, THE GUARDIAN (June 15, 2016, 7:32 AM), <https://www.theguardian.com/world/2016/jun/15/chinas-naked-loans-force-female-students-to-bare-all-in-return-for-more-cash>.

¹⁴⁰ See Agence France-Presse, *China's Tech-Savvy Youth Drowning in Online Debt Trap*, THE STRAITS TIMES (Dec. 16, 2019, 5:00 AM), <https://www.straitstimes.com/asia/chinas-tech-savvy-youth-drowning-in-online-debt-trap>.

¹⁴¹ Maggie Zhang, *China Issues New Rules to Clean Up Runaway Cash Loan Market*, SOUTH CHINA MORNING POST (Dec. 2, 2017, 7:17 AM), <https://www.scmp.com/business/companies/article/2122540/china-issues-new-rules-clean-runaway-cash-loan-market>.

However, there are legitimate concerns over whether the provincial governments will pay attention to enforcing the regulations that give some platforms a chance to conduct regulatory arbitrage. In the context of the ongoing “Internet Plus” movement that favors online lending market development,¹⁴² provincial governments have to strike a balance between over-regulation and under-regulation. Strong supervision could stifle the developing Internet lending market, while weak supervision could trigger systemic financial risks. It is safe for provincial governments to adopt “wait and see” strategies until the central government dictates “strong supervision”.¹⁴³ Some P2P platforms saw no hope of filing at the registration place, so they switched to acquiring small platforms in areas with relatively loose filing requirements and used them as shell resources.¹⁴⁴ In addition, the provincial governments “may pass the bucks to the central government, particularly because the delineation of responsibility is not clear-cut.”¹⁴⁵

D. Unintended Consequences

P2P lending could be a double-edged sword. Advocators praise P2P lending’s inclusiveness which enables marginalized individuals to participate in financial activities and benefit from doing so. However, such inclusiveness can also expose these vulnerable individuals, who usually lack a sophisticated understanding of finance, to financial risks. Ultimately, these individuals are more likely to suffer from the investment in complicated financial products.¹⁴⁶ In the absence of a high degree of self-discipline and ethics, financial markets are rife with fraud, moral hazard, adverse selection and externalities.¹⁴⁷ The online P2P lending market’s violations will lead to long-lasting inefficient financial markets because the “financial refugees” will lose confidence in investing in online P2P lending.¹⁴⁸ Hence, regulations are deemed necessary. The question is to what degree regulators should dictate how P2P platforms conduct their business.

¹⁴² Guowuyuan Guanyu Jiji Tuijin “Hulianwang Jia” Xingdong de Zhidao Yijian (国务院关于积极推进“互联网+”行动的指导意见) [Guiding Opinions of Vigorously Advancing the “Internet Plus” Action] (promulgated by the St. Council, July 1, 2015, effective July 1, 2015) (Chinalawinfo).

¹⁴³ Local authorities adopted the “wait and see” strategy in a variety of policy uptake and adoption. See, e.g., Yu-wai Li, Bo Miao & Graeme Lang, *The Local Environmental State in China: A Study of County-Level Cities in Suzhou*, 205 CHINA Q. 115, 132 (2011). For more discussions, see JAE HO CHUNG, CENTRIFUGAL EMPIRE: CENTRAL-LOCAL RELATIONS IN CHINA (2016).

¹⁴⁴ See Song, *supra* note 114.

¹⁴⁵ Huang, *supra* note 50, at 81.

¹⁴⁶ Angela C. Lyons, John E. Grable & Ting Zeng, *Impacts of Financial Literacy on the Loan Decisions of Financially Excluded Households in the People’s Republic of China* (ADBI Working Paper Series, Paper No. 923, 2019), <https://think-asia.org/bitstream/handle/11540/9761/adbi-wp923.pdf?sequence=1>.

¹⁴⁷ See generally ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* (6th ed. 2016).

¹⁴⁸ See Huifeng He, *China’s P2P “Financial Refugees” Face Never Ending Wait to Recover Lost US\$120 Billion*, SOUTH CHINA MORNING POST (Oct. 21, 2020, 6:00 AM), <https://www.scmp.com/economy/china-economy/article/3106275/chinas-p2p-financial-refugees-face-never-ending-wait-recover> (last visited Dec. 30, 2020).

The constant experimentation and tweaking of regulatory measures have raised some concerns. While the authorities considered direct lending activities on P2P platforms as one type of private lending and subject to relevant laws and regulations such as the Contract Law,¹⁴⁹ they built the “one plus three” regulatory framework with the logic of governing P2P platforms as moneylenders. P2P platforms must register with the local financial regulatory authorities within ten working days after obtaining their business license.¹⁵⁰ P2P platforms are also liable for reporting to local financial regulatory authorities if certain prescribed situations occur.¹⁵¹ P2P platforms that have breached relevant provisions will receive penalties such as a warning letter, an order of correction, a fine up to RMB30,000 and other administrative sanctions issued by the local financial regulatory authorities.¹⁵² These regulatory arrangements indicate that regulators have treated P2P platforms as “de facto financial institutions” and have adopted a regulatory system accordingly. Critics worried about China’s tightened P2P lending regulation, which may be in lack of commercial sustainability, responsiveness and flexibility,¹⁵³ and probably would “hamper the benefits brought by in the P2P lending industry, and stifle innovation in the sharing economy as a whole.”¹⁵⁴

The bizarre phenomenon of market prosperity in the regulation-free period and market recession in the aggressive regulation period is not unique in P2P lending. Similarly, experimentation in China’s out-of-counter market is also directly influenced by the securities market regulation, that is, whether a formal “regulatory perimeter” concept can be installed in securities market regulation.¹⁵⁵ We argue that the unexpected consequence of regulatory experimentation in China’s financial market is related to its *sui generis* financial market condition and political environment, as such, we offer three possible explanations. First, China’s financial market is filled with unsophisticated retail investors. According to a report, China’s stock market is dominated by everyday Chinese citizens who prefer the direct investment market, their investment accounts for 80 percent of all transactions in the market.¹⁵⁶ As a direct investment institution, online P2P lending directly connects lenders and borrowers, and reserves a capital pool. Given China’s chronic financial repression, these retail investors would rush to invest in innovative financing such as P2P lending and neglect its risks.¹⁵⁷ Second, there is a relatively higher

¹⁴⁹ 2015 *Guiding Opinions*, *supra* note 6, art. 8.

¹⁵⁰ 2016 *Interim Measures*, *supra* note 63, art. 5.

¹⁵¹ *Id.* arts. 7 and 37.

¹⁵² *Id.* art. 40.

¹⁵³ Yu & Shen, *supra* note 18, at 53–55.

¹⁵⁴ *Id.* at 55.

¹⁵⁵ Li & MacNeil, *supra* note 17, at 290.

¹⁵⁶ Samuel Shen & Kazunori Takada, *Giving Up on Stock: China’s Retail Investors Seek Safety First*, REUTERS (Jan. 14, 2016, 2:51 PM), <https://www.reuters.com/article/us-china-markets-retail-idUSKCN0US0JS20160114> (last visited Dec. 30, 2020).

¹⁵⁷ For a general discussion of financial repression in China and its consequences, see Guangdong Xu & Michael Faure, *Financial Repression in China: Short-Term Growth But Long-Term Crisis*, 42 LOY. L.A. INT’L

level of inclusiveness in traditional banks in China. Unlike in many other countries where banking wealth management services are mainly targeted at high-net-worth individuals, Chinese commercial banks offer wealth management products and services with much lower access requirements. For example, the threshold for buying banks' wealth management products is RMB 10,000.¹⁵⁸ Third, innovation under hierarchy faces a higher degree of uncertainty because the Chinese authorities consider innovative financing as a way to serve the country's economic development agenda.¹⁵⁹ China's experience with innovative policies has taught us that economic objectives can be compromised if innovation endangers social and political goals.¹⁶⁰ As far as P2P lending is concerned, changes in the way of regulatory experimentation are related to the deviation of P2P lending functions from supporting the real economy and the potential for social instability arising from outstanding loans generated by P2P lending.

V. CONCLUSION

This article evaluated the regulatory experimentation in how China developed its online P2P lending market in recent years. The rise and fall of the online P2P lending market in China gives us a unique opportunity to observe the operation of regulatory experimentation in the *sui generis* Chinese context. The process of experimentation reflected the central government's direct influence on determining the fate of innovative financing. Innovators may find themselves in a regulation-free period and develop beyond the scope of contemporary regulatory oversight when central policies favor innovation. They shall remain sensitive to the overall social, economic and political environment because the central government may flip its friendly policies and tighten ropes around innovators.

The experimentation in China's online P2P lending market has undergone three phases: "lax regulation", "adaptive regulation" and "aggressive regulation". China's regulators have switched between "substantive" and "procedural" regulatory tools at different phases. For instance, regulators adopted three "substantive" regulatory tools during the "adaptive regulation" period, including registration and recordation, third-party custodians, and

& COMP. L. REV. 1 (2019); Li Guo & Daile Xia, *Rethinking State Control over the PRC Financial System: The Black Box of Proactive Intervention*, in THE POLITICAL ECONOMY OF FINANCIAL REGULATION 421, 444 (Emilios Avgouleas & David C. Donald eds. 2019).

¹⁵⁸ Shangye Yinhang Licai Yewu Jiandu Guanli Banfa (商业银行理财业务监督管理办法) [Measures for the Supervision and Administration of the Wealth Management Business of Commercial Banks] (promulgated by the China Banking and Insurance Regulatory Commission, Sept. 26, 2018, effective Sept. 26, 2018), art. 30 (Chinalawinfo).

¹⁵⁹ Heilmann, *supra* note 39.

¹⁶⁰ Wenhsuan Tsai & Nicola Dean, *Experimentation under Hierarchy in Local Conditions: Cases of Political Reform in Guangdong and Sichuan, China*, 218 CHINA Q. 339, 358 (2014); Xufeng Zhu & Youlang Zhang, *Diffusion of Marketization Innovation with Administrative Centralization in a Multilevel System: Evidence from China*, 29 J. PUB. ADMIN. RES. & THEORY 133, 150 (2019).

information disclosure. During the “aggressive regulation”, they used “procedural” regulatory tools to enhance the effectiveness of the existing regulatory framework. This article further discusses the key elements that drove China’s regulators to rely more on a particular type of regulatory tool when regulating the changing P2P lending market. These elements include the identification of the regulated subject, their regulatory objectives, and the dynamic central-local relationship in regulation.

The overall process of regulatory experimentation in P2P lending reflects regulators’ efforts to balance the benefits and risks of financial innovation. While the evidence suggests that some regulatory objectives may have been achieved, lessons should be learned from such regulatory experimentation.¹⁶¹ Nevertheless, there are still benefits to be made in the course of P2P experimentation. Although China’s P2P lending market is fading, the overall online lending market may enjoy a sustainable development stage since the regulators have learned how to govern online lending after their experimentation in P2P lending. The failure of online P2P lending in China teaches policymakers the importance of cost-benefit analysis when encouraging disruptive innovation. While innovation produces high benefits initially, it may also raise severe risks in the later stages. Chinese regulators shall develop clear conceptions of their regulatory objectives toward financial innovation and establish an evaluation system to check the success and failure of their regulatory tools.¹⁶²

¹⁶¹ Amanda Lee, *China’s Scandal-Plagued P2P Sector Faces “Continued Pressure” in 2020 Amid Tightening Regulation*, SOUTH CHINA MORNING POST (Jan. 7, 2020, 4:30 PM), <https://www.scmp.com/economy/article/3045006/chinas-scandal-plagued-p2p-sector-faces-continued-pressure-2020-amid> (last visited Sept. 23, 2020).

¹⁶² For a more detailed discussion of effective regulation, see Baldwin et al., *supra* note 136; MALCOLM K. SPARROW, *THE REGULATORY CRAFT: CONTROLLING RISKS, SOLVING PROBLEMS AND MANAGING COMPLIANCE* (2011).

APPENDIX – LIST OF REGULATORY DOCUMENTS CONCERNING THE
ONLINE P2P LENDING MARKET IN CHINA, 2011-2022

Date	Regulatory Instruments	Authorities	Implications
2011-08-23	Notice on Warning of Risks Associated with Peer-to-Peer Lending ^a	the CBRC	Notifying the banks and local supervisors of the risk of one particular P2Ps.
2013-08-08	Several Opinions on Promoting Information Consumption and Boosting Domestic Demand	the St. Council	Promoting Internet finance innovation but also recognizing the necessity of regulation.
2015-06-22	Notice on Further Implementing the Regulatory Policies on Financial Services for Micro and Small Enterprises ^b	the CBRC	Notifying the banks to supervise their employees in terms of these employees or their relatives involved in the P2P lending business.
2015-07-14	Guiding Opinions on Promoting the Sound Development of Internet Finance	the PBOC et al.	Providing the definition and responsibilities of online lending (online P2P lending and online small loans).
2015-10-19	Opinions on Further Prevention and Disposal of Illegal Fund-Raising ^c	the St. Council	Providing principles and rules for preventing illegal fundraising, including using P2Ps.
2016-04-12	Implementation Plan for Special Rectification on Risks in Internet Finance	the St. Council	Planning for normalizing the online financial business and pointing out the critical rectification issues and work requirements of online P2P lending.
2016-04-13	Notice on Issuing the Implementation Plan for the Special Rectification of Risks	the St. Admin. for Indus. & Com. et al.	Notifying that all relevant departments should focus on the rectification of

	in Internet Financial Advertisements and Financial Activities Conducted in the Name of Investment and Wealth Management ^d		advertisements released by P2Ps.
2016-04-14	Notice on Issuing the Implementation Plan for the Special Rectification of Risks in Conducting Asset Management through the Internet and Engaging in Financial Business in a Crossover Manner	the PBOC et al.	Providing guidelines for investigating and supervising the P2P lending business and distributing tasks to different government agencies.
2016-08-17	Interim Measures for Administration of the Business Activities of Online Lending Information Intermediary Institutions	the CBRC et al.	Emphasizing the legal liabilities of online P2P lending intermediaries.
2016-09-29	Guiding Opinions on Further Strengthening the Monitoring and Early Warning of Suspected Illegally Raising Fund Transactions ^e	the PBOC	Providing guidelines for recognizing the companies that have the potentials to involve in illegal fundraising, and checking whether P2Ps have relevant qualifications.
2016-10-18	Notice on Further Strengthening the Rectification of P2P Lending in Campus ^f	the CBRC et al.	Further notifying the legal risks of campus loans, strengthening the risks warning, education and guidance work of P2P lending on campus.
2016-10-28	Guidelines for the Administration of Recordation and Registration of P2P	the CBRC et al.	Providing a guideline for reporting and registering online lending

	Lending Information Intermediary Institutions		intermediaries.
2017-02-22	Guidelines for the Online Lending Fund Depository Business	the CBRC	Providing a guideline for online lending fund depository business activities.
2017-04-07	Guiding Opinions on Risk Prevention and Control of the Banking Sector ^g	the CBRC	Providing a guideline for risk prevention and management of all banks and asset management companies, arranging special rectification of risks in P2Ps.
2017-08-23	Guidelines for the Disclosure of Information on the Business Activities of Online Lending Information Intermediary Institutions	the CBRC	Providing guidelines for information disclosure of the online lending business activities.
2017-12-01	Notice on the Regulation and Rectification of the "Cash Loan" Business	the Office of the Leading Group for the Special Campaign against Internet Financial Risks et al.	Providing guidelines for regulation and rectification of the "Cash Loan" Business.
2017-12-08	Notice on Carrying Out Work on Special Rectification and Acceptance of Online P2P Lending Risks	the Office of the Leading Group for the Special Campaign against Internet Financial Risks	Providing the principles and standards for examining the cleaning up process of the P2P lending business, setting the deadline for P2Ps to complete registration.
2018-08-17	Notice on Compliance Inspection of Online P2P Lending Intermediary	the Office of the Leading Group for the Special Campaign against Internet Financial Risks	Providing a list of 108 items for local government and regulators to check P2Ps' compliance.

2018-12-19	Opinions on Classified Disposal and Risk Prevention of Online Lending Intermediary Institutions	the Office of the Leading Group for the Special Campaign against Internet Financial Risks et al.	Providing detailed guidelines for ratifying P2Ps according to their inspected problems.
2022-03-01	Decision to Amend the Interpretation of the Supreme People's Court on Several Issues concerning the Specific Application of Law in the Trial of Illegal Fundraising Criminal Cases ^h	Supreme People's Court	Illegal fundraising via online lending shall be convicted of illegal absorption of public deposits.
2022-03-12	Notice of Issuing the Market Access Negative List (2022 version) ⁱ	National Development and Reform Commission and the Ministry of Commerce	Providing a specific negative list that online lending intermediaries cannot touch.
2022-10-28	Report of The State Council on Financial Work ^j	the St. Council	Re-emphasizing on dealing with the risks arising from online P2P lending.

Notice: The regulatory documents in this table are basically issued at the central level.

^a Guanyu Renrendai Youguan Fengxian Tishi de Tongzhi (关于人人贷有关风险提示的通知) [Notice on Warning of Risks Associated with Peer-to-Peer Lending] (issued by the CBRC, Aug. 23, 2011, effective Aug. 23, 2011) (Chinalawinfo).

^b Guanyu Jinyibu Luoshi Xiaowei Qiye Jinrong Fuwu Jianguan Zhengce de Tongzhi (关于进一步落实小微企业金融服务监管政策的通知) [Notice on Further Implementing the Regulatory Policies on Financial Services for Micro and Small Enterprises] (issued by the CBRC, June 22, 2015, effective June 22, 2015) (Chinalawinfo).

^c Guanyu Jinyibu Zuohao Fangfan he Chuzhi Feifa Jizi Gongzuo de Yijian (关于进一步做好防范和处置非法集资工作的意见) [Opinions on Further Prevention and Disposal of Illegal Fund-Raising] (promulgated by the St. Council, Oct. 19, 2015, effective Oc. 19, 2015) ST. COUNCIL GAZ., Feb. 29, 2016 (China).

^d Guanyu Yinfa Kaizhan Hulianwang Jinrong Guanggao Yiji Touzi Licai Mingyi Congshi Jinrong Huodong Fengxian Zhuanxiang Zhengzhi Gongzuo Shishi Fangan de Tongzhi (关于印发《开展互联网金融广告及以投资理财名义从事金融活动风险专项整治工作实施方案》的通知) [Notice on Issuing the Implementation Plan for the Special Rectification of Risks in Internet Financial Advertisements and Financial Activities Conducted in the Name of Investment and Wealth Management] (jointly issued by St. Admin. For Indus. & Com. et al., Apr. 13, 2016, effective Apr. 13, 2016) (Chinalawinfo).

^e Guanyu Jinyibu Jiaqiang dui Shexian Feifa Jizi Zijin Jiaoyi Jiance Yujing Gongzuo de Zhidao Yijian (关于进一步加强对涉嫌非法集资资金交易监测预警工作的指导意见) [Guiding Opinions on Further Strengthening the Monitoring and Early Warning of Suspected Illegally Raising Fund Transactions] (issued by the PBOC, Sept. 29, 2016, effective Sept. 29, 2016) (Chinalawinfo).

^f Guanyu Jinyibu Jiaqiang Xiaoyuan Wangdai Zhengzhi Gongzuo de Tongzhi (关于进一步加强校园网贷整治工作的通知) [Notice on Further Strengthening the Rectification of P2P Lending in Campus] (jointly issued by the CBRC et al., Oct. 18, 2016, effective Oct. 18, 2016) (Chinalawinfo).

^g Guanyu Yinhangye Fengxian Fangkong Gongzuo de Zhidao Yijian (关于银行业风险防控工作的指导意见) [Guiding Opinions on Risk Prevention and Control of the Banking Sector] (issued by the CBRC, Apr. 7, 2017, effective Apr. 7, 2017) (Chinalawinfo).

^h Guanyu Xiugai Zuigao Renmin Fayuan Guanyu Shenli Feifa Jizi Xinshi Anjian Juti Yingyong Falv Ruogan Wenti de Jieshi de Jueding (关于修改《最高人民法院关于审理非法集资刑事案件具体应用法律若干问题的解释》的决定) [Decision to Amend the Interpretation of the Supreme People's Court on Several Issues concerning the Specific Application of Law in the Trial of Illegal Fundraising Criminal Cases] (issued by the Supreme People's Court, 23 Feb. 2022, effective 1 Mar. 2022) (Chinalawinfo).

ⁱ Guanyu Yinfa Shichang Zhunru Fumian Qingdan (2022) de Tongzhi (关于印发《市场准入负面清单(2022年版)》的通知) [Notice of Issuing the Market Access Negative List (2022)] (issued by the National Development and Reform Commission & the Ministry of Commerce, 12 Mar. 2022, effective 12 Mar. 2022) (Chinalawinfo).

^j Guowuyuan Guanyu Jinrong Gongzuo Qingkuang de Baogao (国务院关于金融工作情况的报告) [Report of The State Council on Financial Work] (issued by the State Council, 28 Oct. 2022) (Chinalawinfo).