

# REGULATION OF DIGITAL FINANCIAL SERVICES IN CHINA: LAST MOVER ADVANTAGE?

ZHOU Weihuan\*

Douglas W. Arner\*\*

Ross P. Buckley\*\*\*

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\* Lecturer, Faculty of Law, UNSW Australia. Email: [weihuan.zhou@unsw.edu.au](mailto:weihuan.zhou@unsw.edu.au)

\*\* Professor, Co-Director, Duke-HKU Asia America Institute of Transnational Law, and Member, Board of Management, Asian Institute of International Financial Law, Faculty of Law, University of Hong Kong. Email: [douglas.arner@hku.hk](mailto:douglas.arner@hku.hk)

\*\*\* CIFR King & Wood Mallesons Professor of International Financial Law, Scientia Professor, and Member, Centre for Law, Markets & Regulation, UNSW Australia. Email: [ross.buckley@unsw.edu.au](mailto:ross.buckley@unsw.edu.au)

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### *Abstract*

*Since 1979, China has made tremendous progress in its transformation to a socialist market economy. As part of this process, China's financial system has evolved to one characterised by a high degree of marketization. At the same time, China today faces new challenges to growth and development, particularly from the necessity of restructuring its economy to focus increasingly on innovation and away from government led investment and low-wage labour. In the context of digital financial services, China has been a late mover but this has changed dramatically in the past five years, to the point today where China is one of the major centres for digital financial services and financial technology ("Fintech"). Looking forward, China needs to provide an appropriate regulatory basis for the future development of digital financial services and Fintech, balancing growth and innovation with financial stability. China today is exhibiting signs of a last mover advantage in this respect that may see it leaping regulatory developments elsewhere.*

### I. INTRODUCTION

The rise of digital financial services (DFS) over the past three decades is an important global phenomenon. Today, financial services is probably the most digitized industry, as well as the most globalized, in addition to being for at least the past two decades the single largest component of global technology spending.<sup>1</sup>

In China, DFS developed much later than elsewhere, with major development only beginning in the late 1990s as the financial services sector modernized and developed in the context of the overall process of economic liberalization. Likewise, more recent developments in digital finance (such as internet payment services and peer-to-peer (P2P) lending) began to emerge only in the middle of the last decade. Innovations in DFS in China beyond internet banking and electronic payments are even more recent phenomenon, dating only from the beginning of this decade. Nevertheless, in many ways, China is experiencing a "last mover" advantage in the context of DFS and now appears to be developing more rapidly than most other jurisdictions.

Many factors have contributed to this rapid development, including technological innovation, rapidly increasing use of digital devices and changing consumer behaviour, explosive growth of DFS providers, and the policy objective of the Chinese government to enhance

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<sup>1</sup> See Douglas W. Arner, János Nathan Barberis & Ross P. Buckley, *The Evolution of Fintech: A New Post-crisis Paradigm?* (Sept. 2015), available at <http://ssrn.com/abstract=2676553>.

financial inclusion via digital finance to support growth and encourage greater innovation. The significance of digital finance to the achievement of full financial inclusion has been firmly endorsed by the Chinese government. The expansion of financial inclusion for underserved segments, ranging from rural areas to the urban poor to (perhaps most importantly) non-state small and medium sized enterprises (SMEs), has been one of the key elements of China's financial sector reforms which in turn have been an integral element of China's overall economic reform and innovation strategies.

As well as promoting the development of digital finance, the Chinese government is now dedicated to establishing a regulatory framework to oversee and supervise DFS so as to ensure its healthy growth. The approach seeks to balance the needs for innovation and growth in the economy, particularly in relation to non-state firms and SMEs, with the requirements of financial stability. However, the regulatory efforts of the Chinese government have yet to lead to the establishment of a comprehensive framework, such that DFS remain under-regulated, and in some areas, unregulated in China. In particular, the rapid development of non-traditional forms of DFS such as non-bank electronic payments and P2P lending have often occurred prior to the establishment of a supporting regulatory framework, often to take advantage of gaps in existing legal and regulatory systems. With the release of a new policy framework in July 2015, the Chinese government is seeking to implement a strategically designed framework to balance the sometimes competing objectives of innovation, growth and financial stability.

This paper is organized as follows: Section II provides an overview of China's financial sector reforms since 1978, including the early development and evolution of DFS. It highlights the lack of financial inclusion in China, a significant and longstanding issue that has attracted considerable government effort in the past decade. Despite these efforts, financial services for underserved sectors continues to be a major issue and a roadblock to future growth and innovation. Section III analyses the evolution of DFS over the past decade setting out various forms of digital finance provided by major internet and e-commerce companies, other non-financial institutions and banks. The section shows that the number and scale of digital finance providers has grown phenomenally since 2013, paralleling the increase in the acceptance of DFS by consumers in China.

China's regulatory framework for DFS can be divided into two periods: the initial period before 2015 and the development period since 2015. The initial period witnessed the promulgation of several rules by China's banking regulators on certain types of digital finance such as internet payment and third-party payment services. While these rules contributed to the development of a regulatory framework on DFS, they are inadequate in many respects such as a lack of detailed

and comprehensive provisions for the protection of consumers. Moreover, regulations of many other forms of digital finance will need to be developed. Since early 2015, there has been growing recognition, from both official and unofficial sources, that China needs to accelerate the development of DFS regulation with an aim to establish a preliminary regulatory framework by the end of 2015. On 18 July 2015, ten central government ministries and commissions jointly issued a ‘*Guideline on the Promotion of the Health Development of Internet Finance*’<sup>2</sup> (2015 DFS Guideline). The Guideline clarified a number of important issues and addressed various types of DFS. Further, the Guideline mandates the relevant authorities to develop detailed rules on the areas of digital finance for which they are responsible. The issuance of the Guideline, therefore, reflects a great effort and achievement of the Chinese government. Sections IV and V thus offer a comprehensive study and analysis of China’s regulation of DFS by discussing, respectively, China’s DFS regulations before 2015 (section IV) and the 2015 DFS Guideline (section V). These sections show that digital finance is considered by the Chinese government as being essential to achieve full financial inclusion, and that regulatory efforts have been made to ensure the healthy development of DFS. Section VI concludes, arguing that China is now on the verge of moving from last mover to first mover in respect of both DFS and its regulation.

## II. THE MODERN EVOLUTION OF CHINA’S FINANCIAL SECTOR REFORMS

As one of the central elements of China’s economic reforms since 1978, the modern evolution of China’s financial sector reforms can be divided into four stages.<sup>3</sup>

The first stage encompassed 1978-1990, in which the foundational transformation of China’s financial system from one of central planning and control was commenced. Most significantly, in this period, four state-owned banks – Bank of China (BOC), China

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<sup>2</sup> 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) [Guideline on the Promotion of the Health Development of Internet Finance] (promulgated by PBOC et al., July 18, 2015, effective July 18, 2015) (Chinalawinfo).

<sup>3</sup> The description of the first three phases of China’s financial reforms (i.e. 1978–2013) is mainly based on: Maria M.N. DaCosta & Jennifer P.N. Foo, *China’s Financial System: Two Decades of Gradual Reforms*, 28 *Managerial Finance*, no. 10, 2002, at 4–5; Franklin Allen, Jun Qian & Meijun Qian, *China’s Financial System: Past, Present, and Future*, in *CHINA’S GREAT ECONOMIC TRANSFORMATION* 506, 509–11 (Loren Brandt et al. eds., 2008); Patrick Hess, *China’s Financial System: Past Reforms, Future Ambitions and Current State*, in *CURRENCY COOPERATION IN EAST ASIA* 21, 25–29 (Frank Rövekamp et al. eds., 2014); PETE SPARREBOOM & ERIC DUFLOS, CGAP & WORLD MICROFINANCE FORUM Geneva, *FINANCIAL INCLUSION IN THE PEOPLE’S REPUBLIC OF CHINA: AN ANALYSIS OF EXISTING RESEARCH AND PUBLIC DATA* 1–45 (Aug. 2012). For a comprehensive analysis of China’s financial reforms especially the reforms of the banking sector before 1998, see NICHOLAS R. LARDY, *CHINA’S UNFINISHED ECONOMIC REVOLUTION* (1998).

Construction Bank (CCB), Agricultural Bank of China (ABC) and Industrial and Commercial Bank of China (ICBC) (known as the “Big Four”) – were established to take over the commercial banking businesses of the People’s Bank of China (PBOC); and the PBOC formally assumed the role of China’s central bank. Also established in this period were various other financial institutions or intermediaries such as regional commercial banks in designated areas, Rural Credit Cooperatives (RCCs) which provide banking services in rural areas, Urban Credit Cooperatives (UCCs) as the counterpart of RCCs serving urban areas, and investment and trust companies. These institutions are mainly operated to supplement the lending activities of the “Big Four” with a focus on areas (such as rural areas) and borrowers (such as non-state owned enterprises) with limited access to the state-owned banks.<sup>4</sup> Despite these reforms and developments, the lack of financial inclusion in China was significant given the highly-controlled banking system in which investment, lending and interest rate policies excessively skewed towards state-owned enterprises (SOEs) and designated priority sectors.<sup>5</sup> These policies also caused other glaring and longstanding problems in China’s financial sector such as inefficient allocation of resources, lack of profitability and competitiveness, and mounting non-performing loans (NPLs).<sup>6</sup>

The second stage from 1991 to 2005 was built upon a comprehensive and bold reform strategy designed by the then Premier Zhu Rongji and PBOC Governor Zhou Xiaochuan. This period saw a range of financial reforms with the most significant being, first, the restructuring, commercialization and eventual listing of the “Big Four” in order to enhance their efficiency and profitability and tackle issues such as NPLs; second, the transformation of other financial intermediaries especially RCCs to improve viability and governance; third, the creation and development of China’s bond and stock markets, with the establishment in particular of the Shanghai Stock Exchange and the Shenzhen Stock Exchange in 1990 and the PBOC interbank bond market; and fourth, China’s gradual opening-up of its market for foreign financial institutions following its accession to the World Trade Organization (WTO) in 2001. This period also saw the establishment of the China Securities Regulatory Commission (CSRC) in 1992, the China Insurance Regulatory Commission (CIRC) in 1998, and the China Banking Regulatory Commission (CBRC) in 2003, removing banking regulation from the PBOC. The establishment of the major regulators and their supporting legislative

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<sup>4</sup> See LARDY, *supra* note 3, at 61–76.

<sup>5</sup> See SPARREBOOM & DUFLOS, *supra* note 3, at 7–8. For a discussion of China’s interest rate policy reforms during this period, see Alexander Ballantyne, Jonathan Hambur, Ivan Roberts & Michelle Wright, *Financial Reform in Australia and China*, RESERVE BANK OF AUSTRALIA, Sept. 2014, at 23–25, available at <http://www.rba.gov.au/publications/rdp/2014/pdf/rdp2014-10.pdf>.

<sup>6</sup> See LARDY, *supra* note 3, at 76–127; SPARREBOOM & DUFLOS, at 8.

frameworks thus formed the core components of China's financial regulatory system, necessary to support financial reform and economic growth while maintaining financial stability. These reforms also led to the closure of non-bank financial intermediaries so as to allow the government to "increase its control over monetary flows" and protection of depositors.<sup>7</sup> Investment and loan policies in favour of SOEs remained in place.<sup>8</sup> As a result, the state of financial inclusion deteriorated during this period due to the reduced access to financial services in rural areas and for non-state owned enterprises especially SMEs.<sup>9</sup>

The third stage was 2005-2013 which was characterized by Hess as China's fading period of financial reforms due to the change of leadership and the growing power of conservatives in the government.<sup>10</sup> However, there were a number of significant developments during this period. First, the PBOC eventually lifted the restrictions on lending interest rates in 2013 and proposed to liberalize deposit rates by 2016.<sup>11</sup> Second, the Chinese government continued to liberalize China's exchange rate regime, which led to significant and steady appreciation of the RMB.<sup>12</sup> Third, efforts to improve the health of financial institutions especially the state-owned banks continued and have led to great achievements including, amongst others, significant reductions of NPLs and improvement of capital adequacy, improved internal governance and management in line with recognized international standards, and increasing diversity of businesses of both banks and non-bank financial institutions.<sup>13</sup> Fourth, in line with the central policy goal to "build a harmonious society", the government committed to improve financial inclusion with an ultimate goal to achieve "full banking service coverage".<sup>14</sup> To achieve this, central and local governments took steps to increase the number of conventional financial institutions and the diversity of financial services, which significantly improved financial accessibility in rural areas and for SMEs.<sup>15</sup> Further, various new types of microfinance emerged and developed in this period such as P2P

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<sup>7</sup> See SPARREBOOM & DUFLOS, *supra* note 3, at 9.

<sup>8</sup> *Id.* at 10.

<sup>9</sup> *Id.* at 10-11.

<sup>10</sup> See Hess, *supra* note 3, at 28-29.

<sup>11</sup> See Ballantyne *et al.*, *supra* note 5, at 30.

<sup>12</sup> See Ballantyne *et al.*, *supra* note 5, at 33-34; Ross Buckley & Weihuan Zhou, Navigating Adroitly: China's Interaction with the Global Trade, Investment, and Financial Regimes, 9(1) U. PA. E. ASIA L. REV. 1, 32 (2013).

<sup>13</sup> See Richard Herd, Samuel Hill & Charles Pigott, *China's Financial Sector Reforms*, OECD ECON. DEP'T, Feb. 2010, at 1-11.

<sup>14</sup> See SPARREBOOM & DUFLOS, *supra* note 3, at 13.

<sup>15</sup> See SPARREBOOM & DUFLOS, *supra* note 3, at 16-21. For a comprehensive study of the development of microfinance in China, see "Microfinance in China" published by World Microfinance Forum Geneva in 2010 which consists of a number of articles on China's microfinance, <http://www.microfinancegateway.org/library/microfinance-china-0>.

lending, microcredit companies, village banks, etc.<sup>16</sup> The expansion of financial inclusion supported by government policies has led some observers to characterise this period of reforms as China's "evolution of financial inclusion".<sup>17</sup> Most significantly, this period witnessed explosive growth in China's shadow banking market, in particular wealth management and related structured products designed to avoid lending and interest rate restrictions in China's banking sector but also to provide access to finance to underserved non-state firms, including SMEs. It is also during this period that most financial institutions in China began significant development of DFS, in particular internet banking and electronic payments services necessary to support the growth and development of the economy and to serve increasingly sophisticated consumer needs. This period also included the global financial crisis of 2008 and a return to state direction of credit in support of the economy while seeking to restrain excessive growth of property lending and prices.

The fourth period from 2013 witnessed a renewed focus on financial reform and liberalization and the wave of digital finance currently reshaping China's financial market. It has been observed that 2013 was probably the year that heralded a new phase of financial reforms in China.<sup>18</sup> The drive for reform and liberalisation has included major initiatives to increase the international use of the RMB, to end interest rate controls, to liberalize capital movements and to increase China's overseas investment, particularly in the context of the 'One Belt, One Road' initiative. Regulatory reforms have also proceeded on a range of fronts. In 2014, Chinese regulators licensed 5 private banks (including 2 internet-based banks) and approved the establishment of "13 privately-controlled financial leasing companies, consumer finance companies and finance companies affiliated to corporate groups, and 162 village and township banks with private sector taking dominant shares."<sup>19</sup> In May 2015, the formal deposit insurance system was established.<sup>20</sup> These reflect the continuing efforts of the Chinese government to liberalise the financial sector and to enhance financial inclusion by increasing the number of non-state owned financial services providers to serve underbanked segments. At

<sup>16</sup> See Du Xiaoshan, *The Current Supply of Microfinance Services in China*, WORLD MICROFINANCE FORUM GENEVA (Jan. 2008), available at <http://www.microfinancegateway.org/library/current-supply-microfinance-services-china>; SPARREBOOM & DUFLOS, *supra* note 3, at 21.

<sup>17</sup> See SPARREBOOM & DUFLOS, *supra* note 3, at 12.

<sup>18</sup> For example, China Industry Research Network characterised the year of 2013 as "Year One of China's Internet Finance Era", see <http://www.chinairn.com/news/20131231/120642562.html> (in Chinese).

<sup>19</sup> See Financial Stability Analysis Group of the PBOC, *China Financial Stability Report 2015*, THE PEOPLE'S BANK OF CHINA 31 (May 2015), available at <http://www.pbc.gov.cn/english/130736/2946072/2015090616281480816.pdf>.

<sup>20</sup> Cunkuan Baoxian Tiaoli (存款保险条例) [Regulation on Deposit Insurance] (promulgated by the St. Council, Feb. 17, 2015, effective May 1, 2015) (Chinalawinfo).

the same time, non-traditional forms of digital finance have grown very rapidly in a very short time in China, bringing major challenges to policymakers and regulators. With the release of the 2015 DFS Guideline, the Chinese government has committed to developing a comprehensive regulatory framework on DFS to ensure its sustainable development, balancing the objectives of support for innovation, growth and inclusion with financial stability. The evolution and regulation of DFS in China will be discussed in detail below.

In contrast with China's fast growing economy and increasingly deeper economic reforms, its financial system reforms have progressed much more slowly.<sup>21</sup> Despite the substantial improvement of the stability, profitability and inclusiveness of the financial sector, the sector continues to be predominantly state-owned and hence more policy-oriented than market-oriented, a characteristic reinforced both by the state-directed increase in lending in the wake of the global financial crisis and recently by the state intervention in the stock market during 2015. The longstanding issues of inefficiency, uncompetitiveness and vulnerability of China's financial sector remain to be resolved, and a fully market-based financial system will unlikely be established in a short period of time, if ever.<sup>22</sup> In the view of some observers, the inadequate reforms of, and the unresolved problems in China's financial sector have made the sector "one of the weakest links in the economy" that may "hamper future economic growth" of China.<sup>23</sup>

In respect of financial inclusion, despite the various policies promoting financial services coverage in underserved segments<sup>24</sup>, the lack of financial inclusion is likely to continue given the bias of banks towards state-run companies and designated sectors.<sup>25</sup> More significantly, the potential size of the Chinese market means the number of financial institutions and the types of financial services offered are far from adequate such that there are still large numbers of rural population, non-state firms, SMEs and sectors that do not have full and favourable access to financial services.<sup>26</sup> Accordingly, the development of non-bank financial institutions and new ways and forms of finance to support the establishment and growth of underserved entities and sectors is crucial for China to further improve financial inclusion and "to have a stable and functioning banking

<sup>21</sup> See DaCosta & Foo, *supra* note 3, at 3; Hess, *supra* note 3, at 22; LARDY, *supra* note 3, at 16–17.

<sup>22</sup> See Hess, *supra* note 3, at 29–33.

<sup>23</sup> See Allen, Qian & Qian, *supra* note 3, at 506.

<sup>24</sup> See, for example, Herd, Hill & Pigott, *supra* note 13, at 27–32.

<sup>25</sup> See SPARREBOOM & DUFLOS, *supra* note 3, at 27–29.

<sup>26</sup> See He Guangwen, *An Analysis of Microfinance Demand in China*, WORLD MICROFINANCE FORUM GENEVA (Feb. 2008), available at <http://www.microfinancegateway.org/library/analysis-microfinance-demand-china>; China Association of Microfinance, *A Glimpse at the Microfinance Industry in China*, WORLD MICROFINANCE FORUM GENEVA (May 2008), available at <http://www.microfinancegateway.org/library/glimpse-microfinance-industry-china>.



system in the future”.<sup>27</sup> This will in turn propel China’s transition to a market-based financial system and overall economic reforms and growth.<sup>28</sup>

### III. THE EVOLUTION OF DIGITAL FINANCIAL SERVICES IN CHINA

DFS refer to the delivery of financial services through technologies such as mobile telephones, the internet and other electronic devices and channels.<sup>29</sup> Innovative forms of digital finance are being increasingly introduced in financial markets around the world.<sup>30</sup> As is now widely accepted, DFS has great potential to promote financial inclusion given its accessibility and affordability and the large and rapidly increasing number of mobile and internet users worldwide.<sup>31</sup> In addition, DFS may well have other positive spillover effects, such as promotion of technological innovation and creation of employment opportunities, which will foster economic growth.<sup>32</sup>

Another driving force behind the DFS boom in China has been financial repression. Since the commencement of the process of economic reform, China strictly controlled interest rates of financial institutions to reduce loan costs of SOEs and promote investment.<sup>33</sup> Both deposit and lending interest rates were virtually fixed at levels significantly below market levels<sup>34</sup> until recently when the government liberalized the lending rate in late 2013 while maintaining controls over the deposit rate. The interest rates restrictions created difficulties for private firms to obtain loans from banks due to the shortage of deposits from households.<sup>35</sup> This, in turn, led to strong demands of private firms for other sources of finance and consumers for other channels of investment. The mismatch between these demands and the inadequate supply by traditional financial institutions

<sup>27</sup> See Allen, Qian & Qian, *supra* note 3, at 531–532.

<sup>28</sup> See THE NEW MICROFINANCE HANDBOOK: A FINANCIAL MARKET SYSTEM PERSPECTIVE 1–2 (Joanna Ledgerwood, Julie Earne & Candace Nelson eds., 2013) (Recognising various benefits of financial inclusion and its contributions to economic growth and stability).

<sup>29</sup> See, for example, *Digital Financial Services*, ALLIANCE FOR FINANCIAL INCLUSION, <http://www.afinancial.org/policy-areas/digital-financial-services> (last visited Oct. 27, 2015).

<sup>30</sup> See *id.*; Kate Lauer & Timothy Lyman, *Digital Financial Inclusion*, CGAP 1 (Mar. 10, 2015), available at <http://www.cgap.org/publications/digital-financial-inclusion>.

<sup>31</sup> See ANITA GARDEVA & ELISABETH RHYNE, CTR. FIN. INCL., OPPORTUNITIES AND OBSTACLES TO FINANCIAL INCLUSION: SURVEY REPORT 11–12 (2011), available at <http://www.centerforfinancialinclusion.org/publications-a-resources/browse-publications/205>; Lauer & Lyman, *supra* note 30, at 1.

<sup>32</sup> See Michael Rizzo, *Digital Finance: Empowering the Poor via New Technologies*, THE WORLD BANK (Apr. 10 2014), <http://www.worldbank.org/en/news/feature/2014/04/10/digital-finance-empowering-poor-new-technologies>.

<sup>33</sup> See Ballantyne *et al.*, *supra* note 5, at 24–25.

<sup>34</sup> Bo Hu, *Financial Repression and Interest Rate Liberalization in China*, JORDAN RIVER ECO. CONF. 2014 2 (Apr. 2014), available at <https://economics.indiana.edu/home/conferences/2014-jordan-river-economics-conference/files/2014-05-02-05.pdf>.

<sup>35</sup> *Id.*

has provided a fertile ground for the growth of digital finance.<sup>36</sup> As will be shown below, as non-financial institutions particularly internet finance providers were not subject to the interest rates restrictions, they offered higher deposit rates than those offered by banks to attract investment by consumers.

The boom in DFS has created various challenges for governments. The most imminent challenge has been the need for balanced regulatory frameworks which allow for the sustainable development of DFS while providing necessary oversight and supervision to ensure financial stability, the protection of consumers and the regulation of issues such as money laundering.<sup>37</sup> Full digital financial inclusion requires cooperation among all of the players involved such as banks, non-bank digital finance providers, mobile network operators, internet platform providers and other agents, and requires each player to operate in accordance with laws and professional standards and in good faith.<sup>38</sup> In addition, for DFS to unleash its full potential, digital infrastructure (such as payment systems, digital platforms and channels), electronic devices and DFS applications must be made accessible and affordable to consumers.<sup>39</sup>

#### *A. Evolution of Traditional DFS*

Conventional financial institutions, which remain the dominant players in China's financial market, have been active in creating DFS platforms.

The first ATM in China was introduced by the BOC in 1987 along with the bank's first ATM card 'Great Wall ATM Card'.<sup>40</sup> Since then, China has been at the forefront of the development of the ATM market.<sup>41</sup> For the last decade, in response to the policy directive to enhance financial inclusion, Chinese banks have endeavoured to increase the number of banking facilities including ATMs especially in rural areas.<sup>42</sup> By 2013, ATMs in China had soared to 520,000, making China the largest ATM market in the world.<sup>43</sup> In addition,

<sup>36</sup> TJUN TANG, YUE ZHANG & DAVID HE, BCG, THE RISE OF DIGITAL FINANCE IN CHINA: NEW DRIVERS, NEW GAME, NEW STRATEGY 5–6 (Oct. 2014).

<sup>37</sup> See Louise Malady & Ross Buckley, *The Regulation of Mobile Money in Emerging Markets: State of Play*, UNCDF 30 (Apr. 2014), available at <http://www.clmr.unsw.edu.au/resource/risk/regulation-of-mobile-money/regulatory-state-play-april-2014>.

<sup>38</sup> See Lauer & Lyman, *supra* note 30, at 1–2.

<sup>39</sup> See TANG, ZHANG & HE, *supra* note 36, at 13–27.

<sup>40</sup> ResearchInChina, *China ATM (Automatic Teller Machine) Market Report*, 2008 1 (Aug. 2008), available at <http://www.researchinchina.com/FreeReport/PdfFile/633879276546958750.pdf>; *China's First ATM Card*, BANK OF CHINA, [http://www.boc.cn/en/aboutboc/ab5/200811/t20081119\\_1602016.html](http://www.boc.cn/en/aboutboc/ab5/200811/t20081119_1602016.html).

<sup>41</sup> See ResearchInChina, *supra* note 40, at 4.

<sup>42</sup> See SPARREBOOM & DUFLOS, *supra* note 3, at 16.

<sup>43</sup> *China Overtakes USA as World's Largest ATM Market*, RETAIL BANKING RESEARCH (June 20, 2014), <http://www.rbrlondon.com/newsletters/b325e.pdf>.

China has focussed on the development of advanced technology for ATMs. In May 2015, China launched the world's first facial recognition ATM which includes other high-tech functions such as counterfeit bill recognition and high-speed bank note handling.<sup>44</sup>

In contrast, in e-payments (such as online and mobile payments), China was a late mover with its nationwide interbank network only being established in 2002.<sup>45</sup> However, the development of e-payments in China has been phenomenal since 2006 when the PBOC rolled out the Bulk Electronic Payment System to the whole country.<sup>46</sup> For example, in 2012, major Chinese commercial banks “saw more than 100 percent growth in mobile banking users” and more than 300 percent growth in mobile transaction value.<sup>47</sup> The value and volume of online payments reached RMB 1060.78 trillion and 23.674 billion respectively by 2013, representing an annual increase of 28.89 percent and 23.06 percent respectively.<sup>48</sup> In 2014, the increases were even more rapid with a total of RMB 8.41 trillion mobile payment transactions (a year-on-year (y-o-y) increase of 655.51 percent), RMB 1376.02 trillion online payment transactions by banking institutions (a y-o-y increase of 29.72 percent), and RMB 16.21 trillion online payment transactions by payment institutions (a y-o-y increase of 75.5 percent).<sup>49</sup>

Internet banking was introduced in China by the BOC in 1996, and was quickly adopted by the other major state-owned and privately-owned banks between 1997 and 2002.<sup>50</sup> Since 2002, the number of internet banking users has increased rapidly.<sup>51</sup> By 2012, personal and corporate internet banking transactions had replaced more than 50 percent of over-the-counter transactions in China, with a replacement rate higher than 85 percent at some banks.<sup>52</sup> In 2014, China Minsheng Bank, the largest privately-owned commercial bank in China,

<sup>44</sup> See Jason Hahn, *The World's First ATM with Facial Recognition Technology Is Unveiled to the Public in China*, DIGITAL TRENDS (May 31, 2015), <http://www.digitaltrends.com/cool-tech/the-worlds-first-atm-with-facial-recognition-technology-is-unveiled-to-the-public-in-china/>.

<sup>45</sup> ARLYSS GEASE & JOAN QIU, MAVERICK CHINA RES., CHINA 20/20: THE FUTURE OF MOBILE PAYMENT IN CHINA 4 (Dec. 2012), available at <http://www.maverickchina.com/reports/china-20-20-whitepapers>.

<sup>46</sup> *Id.* See also *Brief Review on the Development of China's Payment System*, CHINA UNIONPAY, [http://en.unionpay.com/merchantService/knowledge/file\\_4420451.html](http://en.unionpay.com/merchantService/knowledge/file_4420451.html) (describing the Bulk Electronic Payment System as the “public platform for financial institutions and payment and settlement organizations in the banking industry to develop creative payment services and extend service functions”).

<sup>47</sup> See LESSA SHARDER & ERIC DUFLOS, CGAP, CHINA: A NEW PARADIGM IN BRANCHLESS BANKING 37 (Mar. 2014).

<sup>48</sup> See Financial Stability Analysis Group of the PBOC, *China Financial Stability Report 2014*, THE PEOPLE'S BANK OF CHINA 116 (Apr. 2014), available at [http://www.centerforfinancialstability.org/fsr/chn\\_fsr\\_201407.pdf](http://www.centerforfinancialstability.org/fsr/chn_fsr_201407.pdf).

<sup>49</sup> See Financial Stability Analysis Group of the PBOC, *supra* note 19, at 123.

<sup>50</sup> Xina Yuan, *Present and Future of Internet Banking in China*, 15 J. INTERNET BANKING & COM., no. 1, 2010, at 3.

<sup>51</sup> *Id.* at 4.

<sup>52</sup> See TANG, ZHANG & HE, *supra* note 36, at 32.

launched its Direct Banking platform to move all of its standardised bank products and transactions online.<sup>53</sup> Minsheng Bank's entry into Direct Banking was quickly followed by the state-owned banks and other jointly-owned banks.<sup>54</sup> This signalled a historic move of China's major banks into the digital finance era such that, predictions are now being made that "direct banks will take more than 10% market share of the retail banking industry (in China) by 2020".<sup>55</sup>

In addition, to promote the internationalisation of the RMB, the PBOC has been actively seeking cooperation with central banks or relevant authorities in various countries or territories to realise RMB settlement of international transactions (e.g. trade and investment) through the RMB Real Time Gross Settlement (RTGS) system.<sup>56</sup> The first such arrangement was concluded by the PBOC with the Hong Kong Monetary Authority in July 2010, and then expanded into Taiwan in August 2012, Singapore in February 2013, the UK in June 2014, South Korea in July 2014, and Australia in November 2014.<sup>57</sup>

### *B. Evolution of Non-Traditional DFS*

The explosive growth in numbers and scale of non-traditional DFS start-ups since 2013 has already begun to reshape China's financial system.<sup>58</sup> Riding the wave of the increasing adoption of new technologies<sup>59</sup>, a number of major digital finance providers have propelled the development of DFS in China.

The pioneer and leading non-traditional DFS provider in China is the Alibaba Group. As the world's largest e-commerce company, the

<sup>53</sup> See TANG, ZHANG & HE, *supra* note 36, at 4.

<sup>54</sup> See Wu Hongyuran, *Minsheng Bank is Latest to Join E-Commerce Fray*, CAIXIN ONLINE (Aug. 23, 2013), <http://english.caixin.com/2013-08-23/100573307.html>; Li Xiaoxiao & Liu Caiping, *Banks Trying Direct Route to Online Future*, CAIXIN ONLINE (Jan. 22, 2015), <http://english.caixin.com/2015-01-22/100777224.html>.

<sup>55</sup> See Hua Zhang, CELENT, CHINA'S DIRECT BANKS: BIRTH OF A NEW BANKING SECTOR (Jan. 5 2015), available at <http://www.celent.com/reports/chinas-direct-banks-birth-new-banking-sector>.

<sup>56</sup> See SWIFT, RMB INTERNATIONALIZATION: IMPLICATIONS FOR THE GLOBAL FINANCIAL INDUSTRY (2011), available at [http://www.swift.com/assets/swift\\_com/documents/products\\_services/RMB\\_White\\_paper\\_internationalisation.pdf](http://www.swift.com/assets/swift_com/documents/products_services/RMB_White_paper_internationalisation.pdf).

<sup>57</sup> See Saikat Chatterjee & Tomasz Janowski, *Factbox: Development of China's Yuan Payment Systems*, REUTERS (July 08, 2014), <http://www.reuters.com/article/2014/07/08/us-china-economy-yuan-idUSKBN0FD2GL20140708>; Australian Securities Exchange & Bank of China, *ASX and Bank of China to Expand Cooperation: Bank of China Appointed RMB Clearing Bank*, (Nov. 19, 2014), <http://www.asx.com.au/documents/asx-news/asx-welcomes-bank-of-china-as-rmb-clearing-bank.pdf>.

<sup>58</sup> See Generally TANG, ZHANG & HE, *supra* note 36, at 1–11. For a more detailed overview of the development of DFS in China, see Financial Stability Analysis Group of the PBOC, *supra* note 48, at 171–176.

<sup>59</sup> See SHRADER & DUFLOS, *supra* note 47, at 6–8, 15–17. For a comprehensive report on China's internet coverage and digital development, see JONATHAN WOETZEL *et al.*, MCKINSY GLOBAL INST., CHINA'S DIGITAL TRANSFORMATION: THE INTERNET'S IMPACT ON PRODUCTIVITY AND GROWTH (July 2014).

group has developed many influential digital finance products.<sup>60</sup> The most significant are:

Alipay<sup>61</sup>, Alibaba's third-party online payment platform launched in December 2004, is the largest and most popular online payment service in China with "more than 300 million registered users in China (and 17 million overseas)" by October 2014.<sup>62</sup> It "handles more than 80 million transactions daily" and had settled 42.3 billion payments by December 2014.<sup>63</sup> As one of the most fundamental and fastest growing products of Alibaba, Alipay is viewed as forming "the core of Alibaba's internet finance ecosystem".<sup>64</sup>

AliFinance, one of the pilot financial products launched by Alibaba in 2010, provides micro-loans to vendors registered on Alibaba and TaoBao platforms.<sup>65</sup> This product is aimed at serving SMEs and sole proprietors which have difficulties in obtaining loans from banks. The product allows all transactions to be done online and provides flexible repayment terms. While individual loan amounts are small, the aggregate scale of AliFinance loans is not insignificant given the large number of registered users with Alibaba and TaoBao. For example, the Consultative Group to Assist the Poor (CGAP) reported that by October 2013 AliFinance had "409,444 borrowers spanning the country with an outstanding portfolio of 105 billion RMB (\$17.2 billion)."<sup>66</sup> Although AliFinance's market share remains marginal (i.e. around 0.1% of the total loans issued by China's banks),<sup>67</sup> it is a successful example of digital lending targeting underbanked customers and has continued to grow. More recently, AliFinance appears to have been replaced by Ant Credit, a new digital finance product of Alibaba aimed at providing micro loans to SMEs and individuals. Partnering with the International Finance Corporation, a member of the World Bank Group, Ant Credit launched the "first

<sup>60</sup> For an overview of the business of the Alibaba Group, see Leesa Shrader, *Microfinance, E-Commerce, Big Data and China: The Alibaba Story*, CGAP (Oct. 11, 2013), <http://www.cgap.org/blog/microfinance-e-commerce-big-data-and-china-alibaba-story>.

<sup>61</sup> For an introduction of Alipay and its associated products, see <http://ab.alipay.com/i/jieshao.htm#en>.

<sup>62</sup> See Christina Larson, *Alipay Leads a Digital Finance Revolution in China*, MIT TECHNOLOGY REVIEW (Jan. 26, 2015), <http://www.technologyreview.com/news/534001/alipay-leads-a-digital-finance-revolution-in-china/>.

<sup>63</sup> *Alipay 2014 Spending Report Sheds Light on Chinese Online Spending Behavior*, ALIBABA GRP. (Dec. 8, 2014), <http://www.alibabagroup.com/en/news/article?news=p141208>.

<sup>64</sup> See Matthias Hendrichs, *Why Alipay is more than just the Chinese equivalent of Paypal*, TECH IN ASIA (Aug. 3, 2015), <https://www.techinasia.com/talk/online-payment-provider-alipay-chinese-equivalent-paypal/>.

<sup>65</sup> See Shrader, *supra* note 60. AliFinance's official website is here: <http://view.1688.com/cms/info/loan/2010/xinxibaoguang/01.html> (in Chinese).

<sup>66</sup> See Shrader, *supra* note 60.

<sup>67</sup> Simon Rabinovitch, *Alibaba Digs Deep for Chinese Banking Treasure*, FIN. TIMES (Aug. 25 2013), <http://www.ft.com/intl/cms/s/0/f956b004-ffee-11e2-9c40-00144feab7de.html#axzz3emowunHf>.

Internet-based gender-finance program in China” on 27 January 2015 committing to “expand financing for women entrepreneurs”.<sup>68</sup>

Alipay introduced Yu’e Bao, and its associated mobile application “Alipay Wallet” in June 2013. Yu’e Bao is essentially an online money market fund in which Alipay customers can deposit money left in their Alipay accounts and earn interest at rates generally much higher than those offered by banks.<sup>69</sup> Yu’e Bao does not require minimum deposits and allows withdrawal at any time.<sup>70</sup> In addition, as “up to 90 percent of Yu’e Bao funds are invested in interbank deposits at 29 large banks, including the big state-owned ones”, investment in Yu’e Bao is secure.<sup>71</sup> With these advantages compared to conventional financial products, Yu’e Bao has quickly become China’s largest online money market fund<sup>72</sup> and the fourth largest worldwide.<sup>73</sup> After only one year, Yu’e Bao had 100 million investors and RMB 570 billion (or more than \$90 billion) assets under management.<sup>74</sup>

In March 2014, Alibaba launched an entertainment crowdfunding scheme to be operated under Yu’e Bao letting users “spend between 100 yuan (\$16.13) and 1,000 yuan (\$161.3) to invest in popular films” and games.<sup>75</sup> The promotion attracted more than 240,000 users in two days of operation and was expected to continue to grow given the size of China’s market for cultural products.<sup>76</sup>

In late 2014, Alibaba restructured its major digital finance businesses such as Ant Credit, Alipay, Ali Wallet, and Yu’e Bao by placing all of the businesses under Ant Financial Services Group (Ant Financial) which became Alibaba’s key digital finance provider.<sup>77</sup> With the consolidated businesses, Ant Financial aims to bring finance to SMEs, individuals and other underserved segments via internet-based solutions and technology, and to work with other financial

<sup>68</sup> Susan Wang, *China’s Women Entrepreneurs Targeted for Small-Business Loans*, ALIZILA (Jan. 27, 2015), available at <http://www.alizila.com/chinas-women-entrepreneurs-targeted-small-business-loans>.

<sup>69</sup> For a good introduction of Yu’e Bao, see Moran Zhang, *Alibaba’s Online Money Market Fund Yu’e Bao: 8 Things You Need to Know*, I. B. TIMES (Mar. 11, 2014), available at <http://www.ibtimes.com/alibabas-online-money-market-fund-yue-bao-8-things-you-need-know-1560601>. The official website of Yu’e Bao is here: <https://bao.alipay.com/yeb/index.htm> (in Chinese).

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> See TANG, ZHANG & HE, *supra* note 36, at 4.

<sup>74</sup> *Id.*

<sup>75</sup> Clifford Coonan, *China’s Alibaba Launches Crowdfunding-Like Service for Film Investment*, HOLLYWOOD REP. (Apr. 1, 2014), <http://www.hollywoodreporter.com/news/china-s-alibaba-launches-crowdfunding-692910>; Neil Gough, *Alibaba to Make Movies With Crowdfunding Idea*, N. Y. TIMES (Mar. 26, 2014), [http://dealbook.nytimes.com/2014/03/26/alibaba-enters-the-movie-business-with-a-kind-of-crowdfunding/?\\_r=0](http://dealbook.nytimes.com/2014/03/26/alibaba-enters-the-movie-business-with-a-kind-of-crowdfunding/?_r=0).

<sup>76</sup> *Id.*

<sup>77</sup> See *Official Launch of Ant Financial Services Group Brings New Financial Ecosystem to China*, ALIBABA GRP. (16 October 2014), <http://www.alibabagroup.com/en/news/article?news=p141016>.

institutions “to create a new financial ecosystem” in China.<sup>78</sup> For example, via its digital finance platforms, Ant Financial has successfully expanded digital financial inclusion in underdeveloped rural areas and has committed to continue to do so by building more digital finance infrastructure and channels in these areas.<sup>79</sup>

In June 2015, Alibaba opened its internet bank called MYbank to offer loans of up to RMB 5 million (or \$800,000) to SMEs.<sup>80</sup> MYbank was one of the private banks approved by the Chinese government in 2014; the first one approved was Tencent’s WeBank (which will be considered below). MYbank is 30 percent owned by Ant Financial, with the other shareholders being China’s major private companies Fosun Group and Wanxiang Group.

Alibaba’s stunning success in DFS has stimulated other internet giants and conventional financial institutions in China to rush into the digital financial market by offering similar digital financial products.

Tencent is one of the oldest and largest internet social-networking and entertainment companies in China currently having more than 1 billion users registered with its massively popular messaging products QQ and WeChat.<sup>81</sup> Listed on the Hong Kong Stock Exchange since 2004, Tencent’s market value reached \$206 billion in April 2015, exceeding that of Oracle (\$190 billion), Amazon (\$178 billion) and IBM (\$161 billion).<sup>82</sup> Tenpay, Tencent’s online payment product providing B2B, B2C and C2C payment services, is China’s second largest online payment platform after Alipay.<sup>83</sup> During China’s 2014 Spring Festival, Tencent launched another innovative online product named “Red Envelope”, tailored to the Festival traditions. It allows customers to give lucky money or red packets to family members and close friends via WeChat.<sup>84</sup> Two days after its launch, the promotion attracted more than 5 million users exchanging over 20 million envelopes.<sup>85</sup> The digital “Red Envelope” carried on its success to the 2015 Spring Festival, witnessing the exchange of 1 billion virtual red envelopes on New Year’s Eve and trouncing Alipay in the “red

<sup>78</sup> *Id.*

<sup>79</sup> See Susan Wang, *Ant Financial Brings Biz Loans, Investment Products to Rural China*, ALIZILA (Mar. 17, 2015), <http://www.alizila.com/ant-financial-brings-biz-loans-investment-products-rural-china>.

<sup>80</sup> See AFP, *China’s Alibaba Launches Internet Bank*, THE AUSTRALIAN (June 26, 2015), <http://www.theaustralian.com.au/business/latest/chinas-alibaba-launches-internet-bank/story-e6frg90f-1227415805816>.

<sup>81</sup> Tencent’s official website is available at: <http://www.tencent.com/en-us/index.shtml>.

<sup>82</sup> See *China’s Tencent Hits \$200 Billion Market Cap for First Time*, REUTERS (Apr. 13, 2015), <http://www.reuters.com/article/2015/04/13/us-tencent-valuation-idUSKBN0N40WN20150413>.

<sup>83</sup> See Vaseem Khan, *Alipay Vs Tenpay – the China Payments Rivalry*, LTP (Feb. 12, 2015), <http://letstalkpayments.com/alipay-vs-tenpay-the-china-payments-rivalry-2/>.

<sup>84</sup> See *WeChat Red Envelope*, WIKIPEDIA (last modified Sept. 27, 2015), [https://en.wikipedia.org/wiki/WeChat\\_red\\_envelope](https://en.wikipedia.org/wiki/WeChat_red_envelope).

<sup>85</sup> See Josh Horwitz, *Chinese WeChat Users Sent out 20 Million Cash-Filled Red Envelopes to Friends and Family Within Two Days*, TECH IN ASIA (Feb. 5, 2014), <https://www.techinasia.com/wechats-money-gifting-scheme-lures-5-million-chinese-users-alibabas-jack-ma-calls-pearl-harbor-attack-company/>.

envelope war”.<sup>86</sup> The success of “Red Envelope” has made Tencent a formidable competitor in China’s digital payment market. As the giving of red envelope requires users to link their bank accounts to their WeChat accounts, the product creates “the basis for [Tencent’s] further financial applications”.<sup>87</sup> For example, in January 2014, Tencent, following in the footsteps of Alibaba, introduced a “Wealth” function into WeChat allowing users to store savings in the investment fund without minimum deposit requirements and to earn an annual interest rate of 6.435 percent.<sup>88</sup> In January 2015, Tencent launched China’s first internet-based bank “WeBank” to serve small-scale borrowers with limited access to loans from state-owned banks.<sup>89</sup> Most recently, Tencent is rolling out to its hundreds of millions of users the possibility to apply for a micro loan up to RMB 200,000 (about \$31,350) directly from WeChat, a new loan feature to WeChat, which is to be operated by WeBank.<sup>90</sup>

Another example is Baidu, one of China’s most famous web services companies that operates China’s largest internet search engine.<sup>91</sup> In October 2013, Baidu launched its own online wealth management product called “Baifa”.<sup>92</sup> Similar to Alibaba’s Yu’e Bao and Tencent’s “Wealth”, Baifa provides a personal investment platform which allows customers to “make a minimum investment of RMB 1 (about \$0.16) and ... [earn] annual interest rates of up to eight percent” higher than the interest rates offered by Yu’e Bao and “Wealth”.<sup>93</sup> While less popular than Yu’e Bao and WeChat, Baifa “reportedly raised USD 165 million from 120,000 customers on the day it launched”.<sup>94</sup> In addition, Baidu has its own personal loan platform called Baidu Finance which allows customers to “borrow up

<sup>86</sup> See David Yin, *Tencent’s WeChat Sends 1 Billion Virtual Red Envelopes on New Year’s Eve*, FORBES (Feb. 19, 2015), <http://www.forbes.com/sites/davidyin/2015/02/19/tencents-wechat-sends-1-billion-virtual-red-envelopes-on-new-years-eve/>; Gabriel Wildau, *Tencent Beats Alibaba in ‘Red Envelope’ App War*, FIN. TIMES (Feb. 27, 2015), <http://www.ft.com/intl/cms/s/0/c39c96c6-be2a-11e4-8cf3-00144feab7de.html#axzz3eyf3RyLo>.

<sup>87</sup> See TANG, ZHANG & HE, *supra* note 36, at 4.

<sup>88</sup> See Paul Bischoff, *WeChat Leaps into Banking, Lets Users Set up Online Investment Fund*, TECH IN ASIA (Jan. 16, 2014), <https://www.techinasia.com/wechat-leaps-banking-lets-users-set-online-investment-fund/>.

<sup>89</sup> See Gabriel Wildau, *Tencent Launches China’s First Online-Only Bank*, FIN. TIMES (Jan. 5, 2015), <http://www.ft.com/intl/cms/s/0/ccc5a6dc-9488-11e4-82c7-00144feabdc0.html#axzz3f4JCnBsS>.

<sup>90</sup> Juro Osawa, *Tencent’s WeChat App to Offer Personal Loans in Minutes*, WALL ST. J. (Sept. 11, 2015), <http://www.wsj.com/articles/tencent-to-add-personal-loan-feature-to-wechat-app-1441952556>.

<sup>91</sup> See *Baidu*, WIKIPEDIA, <https://en.wikipedia.org/wiki/Baidu> (last modified June 18, 2015).

<sup>92</sup> See Josh Horwitz, *Baidu Announces Upcoming Launch of Baifa as It Moves Into Personal Finance*, TECH IN ASIA (Oct. 21, 2013), <https://www.techinasia.com/baidu-announces-upcoming-launch-baifu-moves-personal-finance/>.

<sup>93</sup> *Id.*

<sup>94</sup> Nisha Koul, *Chinese Internet Companies Alibaba, Baidu Offer Financial Services Through Subsidiaries Yu’e Bao, Baifa*, MICROCAPITAL (Feb. 5, 2014), <http://www.microcapital.org/microcapital-brief-chinese-internet-companies-alibaba-baidu-offer-financial-services-through-subsidiaries-yue-bao-baifa/>.



to ten times their monthly income” with a flexible repayment term up to 3 years.<sup>95</sup> Loan applications and approvals are all processed online within as quickly as 5 minutes.<sup>96</sup> Most recently, Baidu launched another online investment fund called “Baifa Youxi” or “Baifa Me” which “lets users crowd-invest in upcoming movies and television shows” and offers an expected interest rate of 8 percent.<sup>97</sup>

In addition to the internet or e-commerce giants above, a large number of other non-financial institutions have engaged in various types of digital finance businesses. For example, in its Financial Stability Report 2014 (PBOC Report 2014), the PBOC has reported that by 2013 there were more than 250 internet payment institutions, “more than 350 active P2P online lending platforms”, and around 21 crowdfunding platforms in the market.<sup>98</sup> These numbers increased dramatically in the past years. For example, while China was already the world’s largest P2P lending market by 2013, the number of P2P lending platforms in China has since continued to grow at a phenomenal pace. By July 2015, there were 2,316 P2P lending platforms in China with settlements of around RMB 82.5 billion transactions in that single month.<sup>99</sup> In respect of crowdfunding, the number of platforms increased to 116 by the end of 2014 and they raised a total of RMB 915 million (about US\$148 million) in that year.<sup>100</sup> Most recently, Dalian Wanda Group, one of China’s largest privately-owned enterprises, was reported as having raised RMB 5 billion (about US\$805 million) via its crowdfunding platforms.<sup>101</sup> The rapid growth of these digital finance platforms shows the great potential of China’s DFS market and the fast-growing demand of investors and consumers for DFS in China.

#### IV. REGULATION OF DIGITAL FINANCIAL SERVICES IN CHINA

While the phenomenal growth of traditional and non-traditional DFS in China in recent years has been fertilised by technological

<sup>95</sup> Paul Bischoff, *Baidu Rebrands Online Finance Service, Introduces Loans*, TECH IN ASIA (Apr. 25, 2014), <https://www.techinasia.com/baidu-rebrands-online-finance-service-introduces-loans/>.

<sup>96</sup> *Id.*

<sup>97</sup> Paul Bischoff, *Baidu Now Lets Anyone Invest in Movies, Will Make Chinese Version of Gone With the Wind*, TECH IN ASIA (Sept. 22, 2014), <https://www.techinasia.com/baidu-lets-invest-movies-chinese-version-emgone-windem/>.

<sup>98</sup> See Financial Stability Analysis Group of the PBOC, *supra* note 48, at 174–175.

<sup>99</sup> The data information is collected from [www.wangdaizhijia.com](http://www.wangdaizhijia.com), a Chinese website providing all sorts of information on P2P lending in China. For a recent report on the development of P2P lending in China, see Liu Mingkan, *Internet Finance and Regulation in China*, ASIA GLOBAL INST. Aug. 14, 2015, <http://www.asiaglobalinstitute.hku.hk/en/internet-finance-regulation-china/>.

<sup>100</sup> Tracey Xiang, *China’s Crowdfunding Market as of 2014*, TECHNODE (Jan. 23, 2015), <http://technode.com/2015/01/23/chinas-crowdfunding-market-2014/>.

<sup>101</sup> Esther Fung, *China’s Wanda Group Raises \$805 Million in Crowdfunding Push*, WALL ST. J. (June 19, 2015), <http://www.wsj.com/articles/chinas-wanda-group-raises-805-million-in-crowdfunding-push-1434687631>.

innovation and advancement and rapidly changing consumer behaviour and adaptation to forms of finance, China's regulatory environment has provided the soil for the growth.

As shown in section II, the Chinese government has made great efforts to promote financial inclusion since 2005. The expansion of financial inclusion for SMEs and in rural areas was one of the policy priorities in China's 11<sup>th</sup> Five-Year Plan.<sup>102</sup> With the rapid advancement and wide adoption of technology, digital finance has been treated by the government as one of the most important means to improve financial inclusion. For example, China's 12<sup>th</sup> Five-Year Plan for the Development and Reform of the Financial Industry gave strong policy direction for the promotion of technology and e-transactions in the financial sector.<sup>103</sup> In line with the policy direction, China's major banking regulators, PBOC and CBRC, have issued many statements and rules consistently aimed at encouraging the use of technology in the financial industry.<sup>104</sup> For example, in the PBOC Report 2014, the PBOC endorsed five major contributions digital finance has made to the Chinese economy, including: (1) promoting inclusive finance, (2) propelling the development of private capital, (3) satisfying the demand of e-commerce development, (4) reducing transaction costs and improving allocation of resources, and (5) encouraging financial product innovation.<sup>105</sup> The CBRC, as early as 2006, introduced *Guidelines of Financial Innovation of Commercial Banks* to "encourage financial innovation, supervise innovative activities, and speed up healthy and continuous development of new banking products and services".<sup>106</sup> More recently in 2012 and 2013, the CBRC re-emphasised the significance of digital finance to the enhancement of financial inclusion and the development of China's financial sector.<sup>107</sup>

While encouraging the continuous development of digital finance, the Chinese government has been aware of the potential risks associated with DFS and the need for regulation. The PBOC Report 2014 identified some of the risks in relation to financial stability, consumer protection, competition in and efficiency of the financial sector, and illegal activities.<sup>108</sup> In a policy briefing held by the State

<sup>102</sup> See Zhou Xiaochuan, *Achievements of Financial Sector Reform and Development in the 11<sup>th</sup> Five-Year Plan Period*, THE PEOPLE'S BANK OF CHINA (Dec. 9, 2010), <http://www.pbc.gov.cn/english/130721/2850258/index.html>.

<sup>103</sup> See *The 12<sup>th</sup> Five-year Plan for the Development and Reform of the Financial Industry*, 38, [http://www.csrf.gov.cn/pub/csrf\\_en/newsfacts/release/201210/W020121010631355001488.pdf](http://www.csrc.gov.cn/pub/csrf_en/newsfacts/release/201210/W020121010631355001488.pdf).

<sup>104</sup> See TANG, ZHANG & HE, *supra* note 36, at 11–12; SHRADER & DUFLOS, *supra* note 47, at 21–27.

<sup>105</sup> See Financial Stability Analysis Group of the PBOC, *supra* note 48, at 172–173.

<sup>106</sup> Shangye Yinhang Jinrong Chuangxin Zhiyin (商业银行金融创新指引) [Guidelines on Financial Innovation of Commercial Banks] (promulgated by CBRC, Dec. 6, 2006, effective Dec. 11, 2006), <http://www.cbrc.gov.cn/EngdocView.do?docID=2897>.

<sup>107</sup> See SHRADER & DUFLOS, *supra* note 47, at 21, 23.

<sup>108</sup> See Financial Stability Analysis Group of the PBOC, *supra* note 48, at 178–179.

Council in January 2015, the need for balanced regulation and supervision of digital finance was emphasised.<sup>109</sup> Two months later during the 3<sup>rd</sup> Session of the 12<sup>th</sup> National People's Congress (NPC), PBOC Deputy Governor Pan Gongsheng reportedly disclosed to the media that a regulatory framework on digital finance will be gradually established within the year and the goal of regulation is to “leave certain space for the development of Internet finance while drawing the bottom line clearly”.<sup>110</sup> As the PBOC is now tasked to lead DFS regulatory activities under the 2015 Guideline discussed below, it is expected that the regulatory framework will be based on the five principles contemplated in the PBOC Report 2014, which were: (1) digital finance shall “aim to enhance the efficiency and capability of financial services” and must not be used for illegal activities such as cash pooling or “engage in securities business”; (2) digital finance must contribute to efficient allocation of resources and financial stability and must not cause abrupt price fluctuation or obvious increase in financial costs; (3) DFS providers must ensure that legitimate rights and interests of consumers are duly protected; (4) DFS providers must engage in fair competition and observe the relevant statutory requirements; and (5) to balance government supervision and industry self-discipline and give full play to self-discipline.<sup>111</sup>

With respect to the division of labour in the regulatory and supervisory framework, the role of the regulators has gradually taken shape. The PBOC leads regulatory activities generally and is “primarily responsible for overseeing payment-related services (such as third-party payment)”, anti-money laundering (AML) activities and the credit reporting industry.<sup>112</sup> The CBRC, with its local offices and supervisory agencies, is mainly responsible for the supervision of P2P lending platforms and crowdfunding and for consumer protection.<sup>113</sup> In addition, the Association of China Internet Financial Industry (ACIFI), China’s industry association on digital finance created in 2014, will be responsible for promoting self-regulation of the industry<sup>114</sup> in line with the 5<sup>th</sup> principle set out in the PBOC Report 2014, rules developed by the financial regulators, and its own articles of association.

<sup>109</sup> See *Full transcript of policy briefing of the State Council on Jan 23, 2015*, ST. COUNCIL OF PRC (Jan. 23, 2015), [http://english.gov.cn/news/policy\\_briefings/2015/01/23/content\\_281475043823916.htm](http://english.gov.cn/news/policy_briefings/2015/01/23/content_281475043823916.htm).

<sup>110</sup> See *China to issue guidelines for Web finance companies*, CHINA DAILY (March. 5, 2015), <http://www.ecns.cn/business/2015/03-05/156739.shtml>.

<sup>111</sup> See Financial Stability Analysis Group of the PBOC, *supra* note 48, at 178–179.

<sup>112</sup> See generally TANG, ZHANG & HE, *supra* note 36, at 12; SHRADER & DUFLOS, *supra* note 47, at 22. See also *Self-regulation of online financial industry*, CHINA DAILY, (Apr.4, 2014), [http://china.org.cn/business/2014-04/04/content\\_32001588.htm](http://china.org.cn/business/2014-04/04/content_32001588.htm).

<sup>113</sup> *Id.*

<sup>114</sup> See *supra* note 112.

Prior to 2015, China's regulatory framework on digital finance was very preliminary. Chinese financial authorities, businesses and scholars have shared the view that it was insufficient for a proper regulation of the rapidly growing digital finance sector.<sup>115</sup> For the Chinese banking regulators, a comprehensive regulatory framework is much needed to "specify the bottom line, strengthen the oversight of the business and guide the industry, which is motivated by innovation, to develop in a healthy and sustainable way."<sup>116</sup>

The remainder of this section considers the major PRC legislation applicable to digital finance before 2015 and identifies their insufficiencies in the regulation of digital finance in China.

### A. CBRC Rules on Internet Banking

In 2006, the CBRC issued *Rules on the Administration of Electronic Banking* (CBRC E-banking Rule)<sup>117</sup>, and *Guidelines on E-banking Security Evaluation*<sup>118</sup> (CBRC E-banking Guideline). In a press conference held by the CBRC, it emphasised the importance of risk management and security of e-banking businesses and clarified that the formulation of the two measures has been based on international standards (particularly *Basel Risk Management Principles for Electronic Banking 2003*<sup>119</sup>) and the regulatory experience of developed countries (particularly the US and the EU).<sup>120</sup>

The objectives of the CBRC E-banking Rule are to strengthen the risk management of e-banking businesses, to protect the legitimate rights and interests of consumers and banks, and to promote the healthy development of e-banking businesses (Article 1). The Rule applies to e-banking services provided by a financial institution via the internet, telephone, mobile phone and wireless networks, and other

<sup>115</sup> For example, see *supra* note 110; see also J. An, B. Zhao & W. Wang, *The Internet Finance in China: The Living Space and the Regulations* 8(S4) INDIAN J. SCI & TECH 106, 106–114 (2015); Bangkun An & Jinyang Ruan, An Bangkun & Ruan Jinyang, *Hulian Wang Jinrong: Jianguan Yu Falü Zhunze* (互联网金融：监管与法律准则) [*Internet Finance: Regulation and Legal Principles*] 3 JINRONG JIANGUAN YANJIU (金融监管研究) [FINANCIAL REGULATION STUDIES] 57, 57–70 (2014); Li Youxing, Chen Fei & Jin Youfang, *Hulian Wang Jinrong Jianguan de Tanxi* (互联网金融监管的探析) [*A Study on the Regulation of the Internet Finance*], 4 ZHEJIANG DAXUE XUEBAO (浙江大学学报) [JOURNAL OF ZHEJIANG UNIVERSITY] 87, 87–97 (2014).

<sup>116</sup> See Financial Stability Analysis Group of the PBOC, *supra* note 48, at 178.

<sup>117</sup> *Dianzi Yinhang Yewu Guanli Banfa* (电子银行业务管理办法) [Measures for the Administration of Electronic Banking] (promulgated by CBRC, Jan. 26, 2006, effective Mar. 1, 2006) (Chinalawinfo).

<sup>118</sup> *Dianzi Yinhang Anquan Pinggu Zhiyin* (电子银行安全评估指引) [Guidelines for the Security Assessment of Electronic Banks] (promulgated by CBRC, Jan. 26, 2006, effective Mar. 1, 2006) (Chinalawinfo).

<sup>119</sup> Basel Committee on Banking Supervision, *Risk Management Principles for Electronic Banking*, July 2003, available at <http://www.bis.org/publ/bcb98.pdf>.

<sup>120</sup> Yinjian Hui Fayen Ren Jiu Dianzi Yinhang Yewu Guanli Banfa he Dianzi Yinhang Anquan Pinggu Zhiyin Da Jizhe Wen (银监会新闻发言人就《电子银行业务管理办法》和《电子银行安全评估指引》答记者问) [CBRC Spokesperson Answers Questions of Reporters on Rules on the Administration of Electronic Banking and Guidelines on E-banking Security Evaluation], CBRC, <http://www.cbrc.gov.cn/chinese/home/docView/2243.html>.

digital devices and networks (Article 2). Financial institutions are defined to include domestic banks, foreign-funded financial institutions established in accordance with the relevant PRC legislation, asset management companies, trust and investment companies, finance companies, financial leasing companies and other financial institutions approved by the CBRC to be established within China (Article 3). The Rule is too detailed to set out in full; but the key provisions can be summarised as follows:

1. Two general principles:

Financial institutions proposing to conduct domestic or cross-border e-banking businesses must (1) seek approval of the CBRC (Article 4), and (2) establish a comprehensive internal risk management and control system and a department with competent personnel to operate and manage the system (Article 6);

2. Domestic e-banking businesses:

To conduct e-banking businesses domestically, financial institutions must satisfy six basic criteria and five additional criteria applicable to the provision of internet banking and mobile phone banking services (Articles 9 & 10). These criteria essentially require financial institutions to have viable e-banking business plans and strategy, and the professional capability, infrastructure, competent personnel and reliable internal system to control and manage risks associated with the operation of e-banking businesses. The detail requirements of application procedures and documents are set out in Articles 15-19 and approval procedures for subsequent alterations in e-banking businesses are set out in Articles 21-26. Financial institutions wanting to close all or part of their e-banking businesses must notify the CBRC three months in advance with the notification made public at the same time (Article 28). Amongst other responsibilities, reporting institutions must take steps to protect the legitimate interests of their customers;

3. Cross-border e-banking businesses:

For cross-border e-banking businesses (that is, the provision of e-banking businesses to customers overseas using the e-banking platform of the financial institutions in China), financial institutions are required to satisfy criteria in addition to those applicable to the provision of domestic e-banking services (Articles 71-74). These criteria mainly concern compliance with laws of the country where the target customers reside, and the reporting to the CBRC of matters such as the scope of the services and the contractual arrangement between the financial institutions and the customers;

#### 4. Internal risk management and external professional evaluation:

Financial institutions are required to prepare a self-evaluation report on an annual basis to report to the CBRC the development, operation and profitability, and risk management of their e-banking businesses (Articles 77-79). In addition, financial institutions are also required to engage a qualified valuation firm recognised by the CBRC to conduct a security evaluation of their e-banking system (Articles 85-86). The qualification requirements of valuation agencies are set out in the CBRC E-banking Guideline. According to the Guideline, a valuation agent can be an internal department of a financial institution or external professional firms (Article 7). The qualification requirements mainly concern whether a valuation agent has the capacity, expertise, experience and competent personnel to conduct security evaluations (Articles 8). In addition to these requirements, an internal valuation department of a financial institution must be independent from the other departments of the institution and must not have been involved in the procurement of e-banking devices for the institution (Article 9). The Guideline also sets out detailed rules on the application and approval of valuation agents, the elements of valuation, and the management of valuation; and

#### 5. Liabilities:

Financial institutions are responsible for any damages suffered by consumers which are caused by factors not attributable to the consumers such as security problems or illegal operations of e-banking systems by the financial institutions (Article 89).

Thus, the CBRC E-banking Rule and the CBRC E-banking Guideline seem to have established a comprehensive mechanism to regulate and oversee the provision of e-banking businesses by financial institutions. The comprehensiveness of the measures is reflected in at least the following aspects. First, they not only cover all typical electronic banking businesses (i.e. internet, telephone and mobile phone banking) but also have the potential to be applied to other forms of electronic banking that may be developed in the future. Second, in addition to conventional financial institutions, the two measures should also apply to newly established financial institutions such as the two internet-based private banks created in 2014 – Alibaba's MYbank and Tencent's WeBank. Third, the risk management system created under the measures tackles some of the most significant risks perceived by consumers using digital banking, that is, security and technical failures.<sup>121</sup> Fourth, the combination of external approval and evaluation with internal self-discipline and management has created a systematic mechanism necessary for the protection of customer rights and interests, the maintenance of

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<sup>121</sup> See Yuan, *supra* note 50, at 5.

financial accountability and the sustainable development of e-banking businesses in China.

However, weaknesses of the two measures can also be identified.<sup>122</sup> For example, they do not provide detailed rules on the protection of clients' information and privacy. In this regard, section 52 of the CBRC E-banking Rule merely requires financial institutions to take proper steps to ensure that e-banking services are operated in a way that complies with relevant laws and regulations. Given the high risk of loss of information and privacy on the internet, it would be necessary for the Rule to provide in detail the steps that financial institutions must take to protect clients' information and privacy and the consequences if they fail to do so. Further, the Rule does not set out in detail the disclosure obligations of financial institutions and hence do not provide sufficient protection for consumers. In addition, the Rule does not contain any provision that deals with money laundering activities. This lack of provisions is intensified given the insufficient supervision of the provision of cross-border e-banking services. In this connection, the Rule merely sets out the documents that need to be lodged to the CBRC by cross-border e-banking services applicants and is silent on the criteria to be applied by the CBRC in deciding whether to approve an application.

### *B. PBOC Rules on Third Party Payment Services*

In 2010, the PBOC issued Rules on the Administration of Payment Services Provided by Non-Financial Institutions<sup>123</sup> (PBOC Payment Rule) and Measures on the Implementation of the Rules on the Administration of Payment Services Provided by Non-Financial Institutions<sup>124</sup> (PBOC Payment Implementation Measure). While the Rule provides the basic framework for the regulation of third-party payment services provided by non-financial institutions, the Measure complements the Rule by providing detailed definitions, application procedures, documentary requirements and other supplementary rules.

<sup>122</sup> See Wang Lanyu (王兰玉), Woguo Wangshang Yinhang Jianguan de Buzu Ji Wanshan Lujing (我国网上银行监管的不足及完善路径) [The Weaknesses of China's Regulation of Internet Banking and Some Recommendations], 11 CAIKUAI YUEKAN (财会月刊) [FINANCE & ACCOUNTING MONTHLY] 92, 92-93 (2011), available at [http://pdf2012.ckyk.cn/upload\\_files/20120331/7868769.pdf](http://pdf2012.ckyk.cn/upload_files/20120331/7868769.pdf); Pan Yong & Xing Yan (潘勇, 邢燕), Lun Woguo Wangshang Yinhang de Jianguan Jiqi Wanshan (论我国网上银行监管及其完善) [An Analysis of China's Regulation of Internet Banking and Some Recommendations], 5 HENAN SHENG ZHENGFA GUANLI GANBU XUEYUAN XUEBAO (河南省政法管理干部学院学报) [JOURNAL OF HENAN ADMINISTRATIVE INSTITUTE OF POLITICS & LAW] (2010), available at <http://old.civillaw.com.cn/article/default.asp?id=51686> (Dec. 28, 2010).

<sup>123</sup> Fei Jinrong Jigou Zhifu Fuwu Guanli Banfa (非金融机构支付服务管理办法) [Administrative Measures for the Payment Services Provided by Non-financial Institutions] (promulgated by PBOC, June 14, 2010, effective Sept. 1, 2010) (Chinalawinfo).

<sup>124</sup> Feijin Rong Jigou Zhifu Fuwu Guanli Banfa Shishi Xize (非金融机构支付服务管理办法实施细则) [Detailed Rules for the Implementation of the Administrative Measures for the Payment Services Provided by Non-financial Institutions] (promulgated by PBOC, Dec. 1, 2010, effective Dec. 1, 2010) (Chinalawinfo).

They are applicable to the third-party payment businesses operated by the internet or e-commerce companies discussed above such as Alibaba's Taobao and Alipay, Tencent's Tenpay, and all of the payment institutions approved by the PBOC.

The PBOC Payment Rule aims to regulate the provision of payment services by non-financial institutions and to protect the legitimate interests of consumers and other stakeholders (Article 1). "Payment Services" refer to monetary transfer services provided by non-financial institutions as an intermediary between payers and payees (i.e. third-party payment services) including internet payment, issuance and acceptance of prepaid cards, acceptance of bank cards, and other payment services prescribed by the PBOC (Article 2).

The Rule sets forth a general prohibition of non-financial institutions or individuals from providing the defined third-party payment services unless they hold a Payment Services Licence (PSL) issued by the PBOC and become a payment institution (Article 3). The main licensing requirements include (1) minimum capital requirements (i.e. RMB 100 million for the provision of payment services nationally or RMB 30 million for the provision of payment services at provincial levels); (2) investor requirements, such as that the main shareholders of a non-financial institution applicant (being one holding 10% or more interests in the applicant or actually controlling the applicant) must have provided payment services for more than two years and made profits for more than two consecutive years; and (3) personnel, organisational and facility requirements (Articles 8-10). A PSL has a term of five years; and renewal applications must be lodged with the local branches of PBOC six months prior to its expiry date (Article 13). Any changes in relation to the name, registered capital, organisational structure, main shareholder of a PSL holder, or merger or demerger of a PSL holder, or alterations of the type or scope of its business must be approved by the PBOC (Article 14).

Further, the Rule sets forth a number of major restrictions or requirements:

(1) a PSL holder must not outsource its payment services; nor is it allowed to transfer, lease or lend its license (Article 17);

(2) a PSL holder must formulate and publicly disclose its standard payment services agreement and lodge a copy of the agreement with the local branch of the PBOC (Article 21); and

(3) restrictions are imposed on how a PSL holder shall deal with funds received from clients for payment services, including that the PSL holder must not treat the funds as its own property; must deposit the funds into a special deposit account opened with and subject to the supervision of a commercial bank; and can only transfer the funds when and as directed by clients (Articles 24, 26 & 29) Further, each PSL holder can only open one special deposit account at one branch



of the commercial bank (Article 26). In addition, the monetary capital paid by a PSL holder must not be lower than 10 percent of its 90 days average balance of clients' funds (Article 30).

Finally, the Rule applies retrospectively to all non-financial institutions which had already engaged in payment services businesses and requires these institutions to obtain a PSL within 1 year of the effective date of the Rule (Article 48).

Thus, the PBOC Payment Rule imposes strict entry thresholds and onerous obligations on third party payment providers. These are necessary to maintain quality services and high levels of consumer protection and to control the potential risks associated with third party payment services (especially those by digital means) and illegal activities. It was predicted that at least half of the non-financial institutions providing third party payment services prior to the promulgation of the Rule may have to exit the market.<sup>125</sup> However, the PBOC has clarified that the Rule is not intended to impose any quantitative restrictions and will allow the issuance of a PSL to all qualified applicants.<sup>126</sup> According to the PBOC, there have been around 270 licensed payment institutions by May 2015.<sup>127</sup> The Rule, therefore, accords with the Chinese government's commitments to a balanced approach to the regulation of internet finance.

After five years of implementation, the weaknesses of the PBOC Payment Rule have surfaced. During the 3<sup>rd</sup> Session of the 12<sup>th</sup> NPC of the PRC, one of the representatives pointed out that the low legislative level of the Rule (being merely a departmental rule) has caused difficulties in encouraging coordination between the PBOC and other regulatory authorities in enforcing the Rule.<sup>128</sup> To remedy this weakness, it is recommended that the State Council formulate and issue regulations on third party payments. Further, the Rule is not sufficiently detailed on issues such as AML and the protection of clients' funds received for payment services. For example, although the Rule attempts to prohibit the misappropriation of clients' funds by

<sup>125</sup> Yingzhi Fang (方盈芝), Fei Jinrong Jigou Zhifu Fuwu Guanli Banfa Jiedu Baogao (《非金融机构支付服务管理办法》解读报告) [An evaluation report on Rules on the Administration of Payment Services Provided by Non-Financial Institutions], CHINA E-COMMERCE RESEARCH CENTRE (中国电子商务研究中心) (June 26, 2010), available at <http://b2b.toocle.com/detail--5232440.html>.

<sup>126</sup> Renmin Yinhang Jiu Fei Jinrong Jigou Zhifu Fuwu Guanli Banfa Dawen (人民银行就非金融机构支付服务管理办法答问) [PBOC Answers Questions of Reporters on Rules on the Administration of Payment Services Provided by Non-Financial Institutions] (June 28, 2010), available at [http://www.gov.cn/zwhd/2010-06/24/content\\_1635734.htm](http://www.gov.cn/zwhd/2010-06/24/content_1635734.htm).

<sup>127</sup> PBOC, *Yihuo Xuke Jigou (Zhifu Jigou)* (已获许可机构(支付机构)) [*Licensed Payment Institutions*], available at <http://www.pbc.gov.cn/zhengwugongkai/127924/128041/2951606/1923625/1923629/index.html>.

<sup>128</sup> Zhang Yuzhe (张宇哲), Zhou Xuedong Daibiao: Ying Jinkuai Chutai Fei Jinrong Jigou Zhifu Fuwu Guanli Tiaoli (周学东代表: 应尽快出台非金融机构支付服务管理条例) [Representative Zhou Xuedong: Regulations on Payment Services Provided by Non-Financial Institutions should be promulgated], CAIXIN.COM (财新网) (Mar. 4, 2015), <http://topics.caixin.com/2015-03-04/100787732.html>.

payment institutions, it is silent on issues such as the payment of interests on funds and whether the funds may be used for investment. Moreover, the monetary penalty imposed on payment institutions for their breach of duties (i.e. up to RMB 30,000) is too low to be an effective deterrence. Finally, the Rule does not contain specific provisions on the regulation and supervision of cross-border third party payment businesses. The improvement of the Rule must also involve the introduction of an exit mechanism for existing payment institutions which fail to obtain or renew their licenses so as to protect the rights and interests of consumers.

### C. Legislation on P2P Lending and Crowdfunding

Over the past five years, the Chinese government has become increasingly aware of the risks and illegal activities (such as cash pooling) that may arise in the context of P2P lending and crowdfunding, and has been considering developing specific rules to regulate these activities.

For example, since 2011, increasing numbers of P2P lending companies have abruptly collapsed due to financial difficulties, and strong voices have been calling for the promulgation of regulations on P2P lending.<sup>129</sup> In response, the CBRC issued the *Circular on Risks Associated with Peer-to-Peer Lending* (CBRC P2P Circular) on 23 August 2011.<sup>130</sup> However, instead of providing specific rules on P2P lending, the Circular merely identifies a number of risks associated with P2P lending as a result of the lack of regulation and supervision, such as illegal funding, fraudulent activities, money laundering, credit and reputational risks, etc. The CBRC P2P Circular has been proven ineffective to control these risks by the high and increasing default rates in P2P lending between 2011 and 2014.<sup>131</sup> These risks may also arise from crowdfunding activities.<sup>132</sup>

Apart from the CBRC P2P Circular, specific regulations or rules on P2P lending and crowdfunding have yet to be promulgated. It has been widely reported that the CBRC has developed draft rules on P2P

<sup>129</sup> Takeshi Jingu, *Risks and Opportunities in China's Growing P2P Lending Market*, NOMURA RESEARCH INSTITUTE 2 (Sept. 10, 2014), available at <https://www.nri.com/~media/PDF/global/opinion/lakyara/2014/lkr2014202.pdf>; Zhang Jinyan (张金艳), *Lun Woguo Renrendai de Fazhan Xianzhuang, Zhuyao Fengxian ji Falü Guifan* (论我国“人人贷”的发展现状、主要风险及法律防范) [An Analysis of the Current State, Major Risks and Regulations of P2P Lending in China], 3 XINAN JINRONG (西南金融) [SOUTHWEST FINANCE] 37, 38–39 (Mar. 23, 2013), available at <http://202.119.108.161:93/modules/showContent.aspx?title=&Word=&DocGUID=fa477088bfla45139fa721de20468e8d>.

<sup>130</sup> Guanyu Renrendai Youguan Fengxian Tishi de Tongzhi (关于人人贷有关风险提示的通知) [Circular on Risks Associated with Peer-to-Peer Lending] (promulgated by the General Office of the CBRC, Aug. 23, 2011, effective Aug. 23, 2011) (Chinalawinfo).

<sup>131</sup> See Liu, *supra* note 99, at 15.

<sup>132</sup> Jerin Mathew, *China Warns of Illegal P2P Lending and Crowd Funding Loopholes*, I. B. TIMES (Apr. 22, 2015), <http://www.ibtimes.co.uk/china-warns-illegal-p2p-lending-crowd-funding-loopholes-1445535>.

lending and crowdfunding and is currently consulting with other authorities, relevant industries, experts and other stakeholders.<sup>133</sup> The latest development is the publication of a consultation draft of *Measures on the Administration of Equity Crowdfunding* in December 2014 by the CSRC and the Securities Association of China (SAC).<sup>134</sup> This instrument makes lawful equity crowdfunding activities and sets out the entry criteria, obligations and liabilities, registration and reporting requirements in relation to equity crowdfunding platforms and investors. However, it appears that the measure is intended to be an industry self-discipline instrument to be administered by the SAC rather than be a CSRC rule. Further, it only covers equity crowdfunding and does not apply to other forms of crowdfunding activities which have represented the majority of crowdfunding platforms in China.<sup>135</sup>

Given the absence of specific regulations on P2P lending and crowdfunding, existing PRC legislation will apply to these activities. For example, the *Contract Law of the PRC*<sup>136</sup> may be considered as providing the legal basis for P2P lending and crowdfunding activities as they are essentially based on different kinds of contractual arrangements. With respect to lending, Chapter 12 of the Contract Law sets out the general rules on loan contracts. Further, the PBOC's *General Rules on Loans*<sup>137</sup> provides more detailed rules on lending activities in general including types of loans, repayment terms, interest rates, rights and obligations of lenders and borrowers, liabilities, etc. However, the Rules were drafted some 20 years ago and do not respond adequately to the novel and complex issues associated with online lending. Moreover, the *Criminal Law of the PRC*<sup>138</sup> condemns activities that constitute illegal taking of deposits from the public (Article 176) and fund-raising by fraudulent means (Article 192); and these provisions also apply to P2P lending and crowdfunding activities. Despite these general laws, therefore, specific rules on P2P lending and crowdfunding are urgently needed to protect the rights and

<sup>133</sup> See, for example, JD Alois, *China Banking Regulatory Commission is Circulating Peer to Peer Lending Rules*, CROWDFUND INSIDER (Mar.19, 2015), <http://www.crowdfundinsider.com/2015/03/64658-china-banking-regulatory-commission-is-circulating-peer-to-peer-lending-rules/>; JD Alois, *China: Draft Regulations Published for Equity Crowdfunding as ShareIn Partners with BOP to Expand*, CROWDFUND INSIDER (Feb.2, 2015), <http://www.crowdfundinsider.com/2015/02/62055-china-draft-regulations-published-for-equity-crowdfunding-as-sharein-partners-with-bop-to-expand/>.

<sup>134</sup> A Chinese version of the consultation draft can be found here, <http://www.sac.net.cn/tzgg/201412/P020141218543931814762.doc>.

<sup>135</sup> See Tracey Xiang, *China's Crowdfunding Market as of 2014*, TECHNODE (Jan. 23, 2015), <http://technode.com/2015/01/23/chinas-crowdfunding-market-2014/>.

<sup>136</sup> Hetong Fa (合同法) [Contract Law of the PRC] (promulgated by the Nat'l People's Cong., Mar.15, 1999, effective Oct.1, 1999) (Chinalawinfo).

<sup>137</sup> Daikuan Tongze (贷款通则) [General Rules on Loans] (promulgated by PBOC, June 28, 1996, effective Aug.1, 1996) (Chinalawinfo).

<sup>138</sup> Xing Fa (刑法) [Criminal Law of the PRC] (promulgated by the Nat'l People's Cong., July 1, 1979, effective Jan.1, 1980, amended 1997, 1999, 2001, 2002, 2005, 2006, 2009, and 2011) (Chinalawinfo).

interests of consumers and safeguard the healthy development of these activities so as to contribute to the stability and growth of China's financial system.

A comprehensive framework is thus lacking, though expected in the near future, as discussed further in the following section.

#### *D. Legislation on Internet Investment Fund*

As with P2P lending and crowdfunding, a regulatory vacuum also exists in relation to the online investment or management funds such as Alibaba's Yu'e Bao, Baidu's Baifa and Tencent's Wealth. PBOC Governor Zhou Xiaochuan has been cited by the media as having highlighted the intention of the government to develop regulations in the sector rather than to crack down on these platforms.<sup>139</sup> In the absence of specific rules, the existing legislation mentioned above provides some basic rules applicable to these activities.

#### *E. Consumer Protection*

As shown above, consumer protection is one of the key objectives of the existing regulations in the digital finance sector. As to specific protections, the PBOC Payment Rule, for example, requires a PSL holder to keep confidential the trade secrets of clients and properly preserve client's information (Articles 33 & 34). The CBRC E-banking Rule, for example, requires e-banking services providers to enter into a service agreement with clients and to disclose to clients matters such as risks, rights and obligations (Article 39). In addition to the specific rules above, consumers' rights and interests are generally protected under general laws such as the *Law of the PRC on Protection of Consumer Rights and Interests*<sup>140</sup> and the *Anti-Unfair Competition Law of the PRC*<sup>141</sup>.

Despite the above, it was widely accepted in the 2015 Forum on the Protection of Consumers in Digital Finance Sector (Forum) held in Beijing that the existing protections afforded to consumers are inadequate and need to be strengthened.<sup>142</sup> The Forum discussed various aspects of consumer protection in the face of the digital finance boom in China such as the obligations of disclosure by DFS

<sup>139</sup> See, for example, Paul Mozur, *Baidu CEO Calls for More Regulation of Online Funds*, WALL ST. J. (Mar.3, 2014), <http://www.wsj.com/articles/SB10001424052702304585004579418141247893328>.

<sup>140</sup> *Xiaofeizhe Quanyi Baohu Fa* (消费者权益保护法) [Law of the PRC on Protection of Consumer Rights and Interests] (promulgated by the Standing Comm. Nat'l People's Cong., Oct.31, 1993, amended 2009, and 2013, effective Mar.15, 2014) (Chinalawinfo).

<sup>141</sup> *Fan Buzhengdang Jingzheng Fa* (反不正当竞争法) [Anti-Unfair Competition Law of the PRC], (promulgated by the Standing Comm. Nat'l People's Cong., Sept.2, 1993, effective Dec.1, 1993) (Chinalawinfo).

<sup>142</sup> 2015 Hulianwang Jinrong Xiaofeizhe Quanyi Baohu Luntan (2015互联网金融消费者权益保护论坛) [2015 Forum on the Protection of Consumers in Digital Finance Sector] (held on Mar.14, 2015 in Renmin University, Beijing), <http://www.xinhuanet.com/live/20150314a/index.htm>.

providers, the rights of consumers to be informed of the risks associated with digital finance products, the enhancement of transparency, the protection of privacy and clients information, the improvement of internet security, the prohibition of fraudulent activities, and the rights of consumers to claim compensation and damages. ACIFI, China's DFS industry association, has also marked consumer protection as one of the four fundamental principles that should guide the development of the sector in the coming years.<sup>143</sup> These efforts suggest that there remains much to be done by regulators to establish a comprehensive mechanism for consumer protection. A typical issue concerns the right of consumers to claim compensation or damages in cases where P2P lending or crowdfunding companies abruptly close and vanish. Given the significance of this issue in recent years, specific rules need to be developed to afford full protection to consumers.

### F. Anti-Money Laundering

Significant international efforts have been made to develop guidelines and common standards for AML as money laundering has become a global issue in the financial sector.<sup>144</sup>

China has been very active in establishing an AML regime.<sup>145</sup> In 2006, China published its first general AML statute, the *Law of the PRC on Anti-Money Laundering*<sup>146</sup> (AML Law). In order to tackle money laundering within financial institutions, the PBOC subsequently formulated a list of instruments including *Rules for Anti-Money Laundering by Financial Institutions*<sup>147</sup> 2006 (PBOC AML Rule), *Measures on the Administration of Reporting of Large-Value*

<sup>143</sup> 2015-2018 Nian Hulanwang Jinrong Fazhan Zhidao Gangyao (2015-2018年互联网金融发展指导意见) [Guidelines on the Development of China's Digital Finance Sector 2015-2018], ACIFI (June 5, 2015), available at <http://www.a-cifi.org/hyzlview.asp?id=998>.

<sup>144</sup> Louise Malady, Ross Buckley & Douglas Arner, *Developing and Implementing AML/CFT Measures using a Risk-Based Approach for New Payments Products and Services*, UNCDF (June 2014), available at [http://www.uncdf.org/sites/default/files/Documents/using\\_a\\_risk-based\\_approach\\_for\\_aml\\_cft\\_measures\\_for\\_new\\_payment\\_technologies\\_june\\_2014.pdf](http://www.uncdf.org/sites/default/files/Documents/using_a_risk-based_approach_for_aml_cft_measures_for_new_payment_technologies_june_2014.pdf); Yan Lixin, Ai Lishan & Tang Jun, *Risk-based AML regulation on internet payment services in China*, 14 JOURNAL OF MONEY LAUNDERING CONTROL 93, 93-101 (2011).

<sup>145</sup> For a comprehensive study on China's AML regime in the financial industry and analysis of the weaknesses of the regime, see Ai Lishan, *Anti-money Laundering (AML) Regulation and Implementation in Chinese Financial Sectors: Money-Laundering Vulnerabilities and the 'Rule-Based but Risk-Oriented' AML Approach* (Mar. 8, 2012) (unpublished Ph.D. thesis, University of Wollongong), available at <http://ro.uow.edu.au/cgi/viewcontent.cgi?article=4643&context=theses>; Nicole Schulte-Kulmann, *How China Fights Money Laundering: Recent Developments in Regulation and Supervision*, CHINA ANALYSIS 7 (Feb. 2007), available at [http://www.chinapolitik.de/studien/china\\_analysis/no\\_56.pdf](http://www.chinapolitik.de/studien/china_analysis/no_56.pdf).

<sup>146</sup> Fan Xiqian Fa (反洗钱法) [Law of the PRC on Anti-Money Laundering], (promulgated by the Standing Comm. Nat'l People's Cong., Oct.31, 2006, effective Jan. 1, 2007) (Chinalawinfo).

<sup>147</sup> Jinrong Jigou Fan Xiqian Guiding (金融机构反洗钱规定) [Rules for Anti-Money Laundering by Financial Institutions] (promulgated by the PBOC, Nov.14, 2006, effective Jan.1, 2007) (Chinalawinfo).

*and Suspicious Transactions by Financial Institutions*<sup>148</sup> 2006 (PBOC Reporting Measure), *Circular on Further Strengthening the Anti-Money Laundering Work of Financial Institutions*<sup>149</sup> 2008 (PBOC AML Circular), and *Measures on the Administration of Anti-Money Laundering and Anti-Terrorist Financing of Payment Institutions*<sup>150</sup> 2012 (PBOC AML and ATF Measure on Payment Institutions). In addition, AML provisions have also been incorporated into some of the existing regulations on digital finance. For example, in applying for a PSL under the PBOC Payment Rule, one of the requirements is that the applicant must have adopted proper AML measures and must observe the relevant AML laws (Articles 6 & 8).

The Research Group on Equity Market Regulation, which has undertaken a research project into China's AML regime, provided a good high-level summary of China's AML laws as follows:

Anti-money laundering regulation in the PRC in essence follows a 'command and control' model by imposing legal standards on certain - financial and non-financial - institutions vulnerable to money laundering activities and by designing governmental institutions responsible for supervising the implementation of these standards as well as for imposing sanctions in case of violations of anti-money laundering regulations and standards.<sup>151</sup>

The AML Law is based on three overarching objectives including protection of financial integrity, anti-corruption and harmonisation with international standards.<sup>152</sup> The Law applies to all financial institutions established in China and "the special non-financial institutions that are required by relevant regulations to perform the obligation of" AML (Article 3). It sets out in detail the responsibilities of relevant authorities in supervising AML activities (Chapter II), the obligations of financial institutions in combating money laundering (Chapter III), substantive and procedural rules on AML investigations

<sup>148</sup> Jinrong Jigou Da'e Jiaoyi he Keyi Jiaoyi Baogao Guanli Banfa (金融机构大额交易和可疑交易报告管理办法) [Measures on the Administration of Reporting of Large-Value and Suspicious Transactions by Financial Institutions] (promulgated by the PBOC, Nov.14, 2006, effective Mar.1, 2007) (Chinalawinfo).

<sup>149</sup> Guanyu Jinyibu Jiaqiang Jinrong Jigou Fan Xiqian Gongzuo de Tongzhi (关于进一步加强金融机构反洗钱工作的通知) [Circular on Further Strengthening the Anti-Money Laundering Work of Financial Institutions] (promulgated by the PBOC, Dec.30, 2008, effective Dec. 30, 2008) (Chinalawinfo).

<sup>150</sup> Zhifu Jigou Fan Xiqian he Fan Kongbu Rongzi Guanli Banfa (支付机构反洗钱和反恐怖融资管理办法) [Rules on the Administration of Anti-Money Laundering and Anti-Terrorist Financing of Payment Institutions] (promulgated by the PBOC, Mar.5, 2012, effective Mar.5, 2012) (Chinalawinfo).

<sup>151</sup> The project is run by Professor Sebastian Heilmann and Nicole Schulte-Kulmann – the quote is extracted from the project description, available at: <http://www.chinapolitik.de/regem/aml/index.html>.

<sup>152</sup> See Kulkmann, *supra* note 145, at 7–8; Ai, *supra* note 145, at 67–70.

(Chapter IV), and liabilities of the relevant authorities, financial institutions and their responsible officers and employees (Chapter VI). Further, the Law establishes a mandate for China to participate in international AML efforts including to work with other countries in AML activities (Chapter V). In addition, given the close connection between money laundering and terrorist activities, Article 36 of the AML Law extends the applicability of the law to the monitoring of the financing of terrorist activities. According to some observers, the AML Law has substantially improved China's AML regime by making it more comprehensive, clear and consistent with international standards.<sup>153</sup>

The introduction of the PBOC AML Circular in 2008 marked a shift in China's AML regime from a command-and-control-based approach to a more risk-based approach (RBA).<sup>154</sup> The Circular mandates the strengthening of internal AML-control and risk management mechanisms of financial institutions, the conducting of customer due diligence (CDD) based on identified risk levels of customers, and the establishment of a risk-based record-keeping and reporting system. This is a further step towards an internationally recognised approach to AML.<sup>155</sup>

Despite the progressive development of China's AML regime, the current regime retains significant weaknesses. For example, the current AML regime focuses on financial institutions and does not fully cover non-financial entities. The AML Law states that it applies to "the special non-financial institutions that are required by relevant regulations to perform the obligation of" AML. However, the term "special non-financial institutions" is not defined in either the AML Law, the PBOC AML Rule or the PBOC Reporting Measure, making it unclear as to what non-financial entities are embraced by the current regime. This lack of definition or clear inclusion, as some have pointed out, was due to the resistance of non-financial businesses and professions in China to the potential responsibilities they would have to assume under the AML regime.<sup>156</sup> Accordingly, the regulation of money laundering activities by non-financial entities has been largely left for further regulatory efforts. One such example is the PBOC AML and ATF Rule on Payment Institutions which has clearly included non-financial payment institutions established in accordance with the PBOC Payment Rule into the AML regime. However, as non-financial institutions are growing in number and scale in all sorts of digital finance businesses in China, other specific regulations are urgently needed to tackle money laundering and terrorist financing

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<sup>153</sup> See Kulkmann, *supra* note 145, at 11–12; see also Ai, *supra* note 145, at 68.

<sup>154</sup> See Yan, Ai & Tang, *supra* note 144, at 97.

<sup>155</sup> See Yan, Ai & Tang, *supra* note 144.

<sup>156</sup> See Kulkmann, *supra* note 145, at 12–13.

activities by these institutions. Moreover, the current AML awareness system, which aims to inform customers of the risks and harms of money laundering and promote their cooperation in AML, has remained underdeveloped given the lack of detailed rules and guidance on the content and conducting of awareness activities.<sup>157</sup> To remedy this weakness, the Chinese government needs to develop a more comprehensive and workable CDD system including, for example, detailed requirements of ‘Know Your Customer’ (KYC) in line with international standards.<sup>158</sup> Furthermore, China’s AML regime lacks the capacity to deal with, and hence is vulnerable to, AML activities based on new technology and new forms of financial services.<sup>159</sup> Given these developments in the financial industry, new rules on CDD, record-keeping and reporting also need to be developed. Finally, a comprehensive RBA to AML has yet to be established. This would require detailed and workable rules on, for example, risk ratings of customers, types of financial services, and jurisdictions; internal risk management; record-keeping and reporting; and gathering, sorting and assessing risk-related information.<sup>160</sup> In fact, a RBA to AML has been regarded as an effective means to tackle money laundering by financial and non-financial institutions in the digital finance era.<sup>161</sup> In addition, two major shortcomings can be identified with respect to implementation and enforcement of China’s AML regime. One concerns the fact that most of the commercial banks in China remain state-owned and hence state-protected, which increases the difficulties of detecting and sanctioning money laundering activities.<sup>162</sup> The other concerns the lack of a clear division of labour between China’s financial regulators, which increases the difficulties of institutional coordination and adversely affects the implementation and enforcement of the AML regime.<sup>163</sup>

In short, the problems of China’s current AML regime have to do with almost every aspect of the regime from existing laws and regulations to implementation and enforcement. Future regulatory efforts of the Chinese government, especially the financial authorities, should develop comprehensive, detailed and workable rules based on international standards but tailored to the regulatory environment in China. The rules must have the capacity to deal with AML activities by financial and non-financial entities through new forms and means of finance, while at the same time leaving sufficient space for the sustainable development of digital finance in China.

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<sup>157</sup> See Ai, *supra* note 145, at 92–93.

<sup>158</sup> See Ai, *supra* note 145, at 140–143.

<sup>159</sup> See Ai, *supra* note 145, at 192–200.

<sup>160</sup> See Ai, *supra* note 145, at 228–262.

<sup>161</sup> See Yan, Ai & Tang, *supra* note 144; Ai, *supra* note 145, at 264–301.

<sup>162</sup> See Ai, *supra* note 145, at 135.

<sup>163</sup> See, for example, Kulkmann, *supra* note 145.



## V. THE 2015 DFS GUIDELINE

The year 2015 has seen increasing efforts of the Chinese government to promote the development of a comprehensive regulatory framework for DFS. The promulgation of the 2015 DFS Guideline is a significant achievement in the regulatory process, and provides a roadmap for the regulatory work of responsible authorities.

The Guideline reiterates the significance of digital finance to the expansion of financial inclusion and confirms the overarching principle and policy orientation as being to support and promote the development and growth of DFS in China. Specific approaches laid down in the Guideline include to:

(1) actively promote the innovation of platforms and types of DFS by financial institutions, internet companies and e-commerce companies in accordance with relevant laws and regulations. A list of encouraged DFS is set out in the Guideline including internet payment, online lending, equity crowdfunding and other digital financial products;

(2) encourage cooperation between digital finance providers, including between banks and internet firms, and between internet firms and other institutions providing financial services to SMEs and individuals. An attempt has been made to encourage banks to provide deposit, fund management and settlement services to third party payment services providers and online lending platforms. This is significant as banks have previously been reluctant to do so and have imposed very high technical requirements and costs in practice;

(3) create a more favourable environment for the financing of DFS providers by encouraging other entities and individuals to create DFS funds, qualified digital finance providers to apply for listing on domestic stock exchanges, and banks to support DFS start-ups;

(4) streamline and decentralise the administration of DFS by mandating the relevant regulatory authorities to provide full support for digital finance providers in a range of regulatory areas, from the administration of company registration by industry and commerce departments and the administration of telecommunication services by telecommunication regulators, to internet censorship and the protection of intellectual property rights of digital finance providers;

(5) provide tax benefits for DFS start-ups and innovative digital finance providers; and

(6) establish supportive infrastructure for the development of DFS especially credit information systems, information-sharing systems and information safety maintenance systems. Qualified digital finance providers will be given access to credit information databases and be allowed to apply for permits to conduct credit information businesses in accordance with relevant laws and regulations.

At the same time, the Guideline reiterates the necessity to regulate and supervise DFS so as to ensure it develops in a healthy and sustainable way that serves the overall reforms and growth of China's financial sector. The Guideline sets out a number of high-level regulatory approaches including clearly defining the boundaries and entry thresholds of different DFS, clarifying the division of responsibilities among regulatory authorities, controlling the potential risks associated with DFS, protecting the legitimate interests of digital finance providers and customers, and penalising illegal activities. Significantly, the Guideline clarifies that internet payment services, online lending services (including P2P lending and micro-loans), and online equity crowdfunding services, in principle, are to be limited to small value transactions. This finds support in a recent study showing that with respect to P2P lending, larger loan sizes are likely to lead to larger NPL sizes.<sup>164</sup> Further, the businesses of online lending platforms should mainly focus on facilitating the exchange of information between borrowers and lenders, and must not include any type of credit information services or engage in illegal fundraising. Finally, a number of major obligations are imposed on online investment fund management platforms focusing on product and risk disclosure, risk and fund management, and consumer protection.

With respect to the division of responsibilities between financial regulators, the Guideline officially confirms that the PBOC is responsible for the regulation and supervision of internet payment services and the CBRC responsible for the regulation and supervision of online lending services. It further clarifies that the CSRC is to be responsible for regulating and supervising equity crowdfunding activities and online investment fund management services.

In addition to the main financial regulators above, the other regulatory authorities and their responsibilities include:

(1) telecommunication departments to administer the registration of websites of digital finance providers;

(2) the Ministry of Industry and Information Technology (MIIT) to supervise telecommunication-related businesses involved in the provision of DFS; and

(3) the State Council Internet Information Office to monitor and regulate all information related to DFS.

Finally, for all types of digital finance, the Guideline sets forth a number of major areas of regulation and key regulatory propositions in each area that need to be further developed in the subsequent regulatory process, including: (1) the preservation and management of clients' reserve funds; (2) product and risk disclosure and investor information disclosure; (3) the protection of consumers; (4) the protection of internet security and information safety; and (5) the

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<sup>164</sup> See Liu, *supra* note 99, at 28.

prohibition of money laundering activities and financial crimes. At least two propositions are worth highlighting. First, it has been made a principle that clients' funds received by payment institutions for payment services must be deposited with and managed by a banking institution. This serves to protect the safety of clients' money in relation to all types of DFS. Second, the regulatory authorities will jointly develop technical safety standards for DFS. This suggests that such standards will become one of the entry thresholds for digital financial providers.

In sum, while the Guideline merely sets out high-level principles for the development of DFS regulations, it has made clarifications on a number of important issues. First, DFS is not to be limited to the existing types of digital financial products (such as internet payment, online lending, crowdfunding, and online wealth management funds); rather, new forms of DFS are encouraged and welcomed. Second, the boundaries of different types of DFS and the roles of different digital financial providers (such as banks, internet firms and e-commerce companies) are to be clearly defined. This will not only simplify the supervisory work of regulatory authorities, but will also contribute to the development of a systematic and disciplined digital finance market. Third, in principle DFS should be limited to small value transactions. This safeguards the efficiency and cost-effectiveness of digital finance on one hand, and avoids the larger risks associated with conducting larger transactions by digital means on the other hand. Fourth and as mentioned above, the Guideline has clarified the division of responsibilities between the relevant regulatory authorities. This will facilitate the coordination between the authorities in formulating DFS regulations, and in overseeing and supervising DFS activities in practice. Lastly, the Guideline has laid down the main regulatory propositions providing clear guidance for the development of a comprehensive regulatory framework on DFS going forward.

Following the release of the Guideline, regulatory activities have been emerging rapidly with several important and specific draft regulations or rules released within just one month. The most important include the consultation draft *Rules on the Administration of Internet Payment Business by Non-Bank Payment Institutions*<sup>165</sup> issued by the PBOC on 31 July 2015 and the consultation draft *Regulation on Non-Depositing Loan Institutions*<sup>166</sup> issued by the

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<sup>165</sup> Fei Yinhang Zhifu Jigou Wangluo Zhifu Yewu Guanli Banfa Zhengqiu Yijiangao (非银行支付机构网络支付业务管理办法征求意见稿) [The Consultation Draft on Rules on the Administration of Internet Payment Business by Non-Bank Payment Institutions] (issued by PBOC, July 31, 2015), available at [http://www.gov.cn/xinwen/2015-07/31/content\\_2907209.htm](http://www.gov.cn/xinwen/2015-07/31/content_2907209.htm).

<sup>166</sup> Fei Cunkuan Lei Fangdai Zuzhi Tiaoli Zhengqiu Yijian Gao (非存款类放贷组织条例征求意见稿) [The Consultation Draft on Regulation on Non-Depositing Loan Institutions] (issued by Legislative Affairs Office of St. Council, Aug. 12, 2015), available at <http://www.chinalaw.gov.cn/article/cazjgg/201508/20150800478726.shtml>.

State Council on 12 August 2015. With this momentum, a comprehensive regulatory framework for DFS by the end of the year would not surprise.

#### IV. LAST MOVER OR FIRST MOVER?

Almost four decades of economic reforms have brought China extraordinary, continuous development and growth. China's financial sector reforms have progressed relatively more slowly due to state domination and control, amongst other factors. Consequently, while financial inclusion has long been relatively weak in China and its expansion one of the government's policy priorities, it has been improved slowly. While traditional DFS (e.g. ATMs) have been growing since early in the reform era, more technology-oriented DFS (e.g. e-payment and internet banking) have not seen rapid growth until the last decade. It is only in the last decade that China has come to realise the significance of DFS to the improvement of financial inclusion and hence has started to promote the growth of DFS. Furthermore, the more innovative forms of DFS, such as P2P lending, crowdfunding, online investment fund management, and online micro loans, have been a recent phenomenon in China, mostly after 2013. Thus, there is no doubt China has generally been a late mover in the development of DFS.

China, however, has become one of the world's largest DFS markets<sup>167</sup> and among the most active of regulators of digital finance in a short period of time. Thanks to the supportive regulatory environment and technological advancement, financial institutions, non-financial institutions and other entities have all entered into DFS development to meet the rapidly growing needs of investors and consumers. With the explosive growth in almost every non-traditional form of digital finance, China has overtaken many other earlier starters in DFS. The problems and risks associated with DFS have quickly emerged and the Chinese government has been determined to accelerate the establishment of a comprehensive regulatory framework to oversee and supervise DFS and ensure its healthy growth. While the regulations prior to 2015 are fragmented and inadequate, the publication of the 2015 DFS Guideline signals a strong political will to accomplish the regulatory work sooner rather than later with an expected deadline of the end of 2015. With this aggressive deadline is

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<sup>167</sup> See, for example, Shai Oster, *A Hundred Apps Bloom in China as Millions Bank on Their Phones*, BLOOMBERG BUSINESS (Aug. 20, 2015), <http://www.bloomberg.com/news/articles/2015-08-19/wechat-baidu-and-alibaba-help-chinese-embrace-digital-banking>. A recent ranking of billion dollar FinTech start-ups sees China in the number one spot, with LuFax (P2P lending) valued at US\$10 billion, followed by Square (online payment) in the USA at US\$6 billion valuation. See Oscar Williams-Grut, *The 24 Fintech 'Unicorns' Worth over \$1 Billion Ranked by Value*, BUSINESS INSIDER AUSTRALIA (Aug. 21, 2015), <http://www.businessinsider.com.au/the-25-fintech-unicorns-ranked-by-value-2015-7/#4-stripe-online-payment-processing-22>.

met or not, China will most likely become a front-runner worldwide in development of a sustainable, effective regulatory framework for DFS.

