

# Fintech Development and Regulation in China

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## ABSTRACT

Due to rapid development of science and technology in China, the development of finance and technology has shown a higher level of integration. However, it also has exposed the lag of the regulatory model, which cannot meet the development requirements of China's financial technology. In the study of the development of Fintech in China, this paper proposes the path to China's Fintech supervision by drawing lessons from the British sandbox supervision model: On the one hand, China should change the traditional supervision mode from separate supervision to multi industry integration supervision. On the other hand, we should promote the supervision sandbox to encourage financial innovation and use the sandbox to simulate and predict risks, so as to effectively control the risks of financial technology.

**Keywords:** *Fintech, British sandbox regulatory, Financial regulation*

## 1. INTRODUCTION

With the development of financial technologies such as big data, cloud computing and blockchain, financial risks are becoming more and more noticeable. Through the research and analysis of the development path of China's financial technology, this paper finds the problems existing in China's financial supervision, and puts forward the localization of the supervision sandbox through the reference of the British financial supervision sandbox, in order to increase the supervision of China's financial technology market without affecting the market flexibility, It also provides theoretical ideas for the further promotion of regulatory sandbox in China.

## 2. THE CONNOTATION AND CLASSIFICATION OF FINANCIAL TECHNOLOGY

### 2.1. Concept

Fintech is an acronym for finance and technology. Through the use of various types of technology, the innovation of products and services offered by the traditional financial industry reduces operating costs and enhance efficiency and effectiveness. The expression "Fintech" was first introduced by American Banker, a financial institution magazine, in a report on Citibank's FSTC program. In March 2016, the Financial Stability Board (FSB) released the "Framework Report on the Description and Analysis of Fintech", which provided

the first preliminary definition of Fintech at the level of international organizations. This term refers to promoting financial innovation through technical means to form business models, technology applications, processes and products that have a significant impact on financial markets, institutions and financial services. In 2017, in China Mainland, the People's Bank of China established the Financial Committee with the aim of strengthening research planning and coordination of Fintech.

### 2.2. Classification

The meaning of Fintech is different in diverse businesses. The Basel Committee on Banking Supervision classifies Fintech into four categories: payment and settlement, deposit and loan and capital raising, investment management, and market facilities<sup>[1]</sup>.

#### 2.2.1. Payment and settlement

The first category is small retail payment services for individual customers, who rely on third-party payment means for peer-to-peer remittances and digital currency applications; the second category is large wholesale payment services for institutional customers, including cross-border payments, foreign exchange, etc., to exchange virtual values over the network.

### *2.2.2. Deposit and loan and capital raising*

Deposit and loan and capital raising services are mainly designed to encounter the funding shortage of individuals and small firms that are not adequately covered by traditional finance. It mainly includes P2P network lending and equity crowdfunding. That is, if small enterprises raise the funds, they need it from qualified investors within a certain range through the Internet platform in the form of bonds or equity.

### *2.2.3. Investment management*

The investment management category is mainly divided into intelligent investment services and electronic trading services. Among them, intelligent investment is based on the investor's risk appetite, tolerance and expected return through big data measurement and portfolio optimization. This help investors to develop a suitable individualized asset allocation to minimize risk and improve the rate of return for investors.

### *2.2.4. Market equipment*

It includes not only basic technical support that can be used across industries, such as customer identity authentication and multi-dimensional data collection and processing, but also technical infrastructure such as distributed accounts, big data, and cloud computing. Among the above four types of business, the first three types of business have obvious financial attributes, which are generally financial businesses and are included in financial supervision; the fourth category is not unique to the financial industry or technology applications, and is usually defined as those provided for financial institutions. Third-party services, however, with the in-depth integration of technology and finance, will have a progressively significant effect on the sound undertaking of permitted financial institutions, requiring more attention from regulatory agencies.

## **3. THE DEVELOPMENT OF CHINA'S FINANCIAL TECHNOLOGY**

### *3.1. Fintech 1.0 era*

The financial technology 1.0 era is the first stage of China's financial technology development. From 1993 to 2012, it is known as China's financial electronization period. It is mainly a simple online operation, which can enhance facility effectiveness and administration position. In 1993, the proposal of the computer network of the banking system opened the era of China's financial electronization. During this period, Internet finance developed rapidly; P2P network platforms increased swiftly, and crowdfunding financing platforms gradually increased. The scale of China's

financial informatization grew from small to large, and the strength also became from weak to strong. In 1997, China Merchants Bank launched the first online banking in China. In 2004, Alipay was founded as the largest third party payment platform in China. In 2006, China's first P2P lending platform was established and PPDAl was established in 2007. It became the first online credit lending platform in China. The first third party payment license was issued by the people's Bank of China in 2011. The first Chinese public financing company named Time was established.

### *3.2. Fintech 2.0 era*

Along with the rapid growth of the Fintech market flake, Fintech continues to penetrate in the traditional financial sector, improving and upgrading traditional financial products and facility. Fintech 2.0 era is the second stage of China's Fintech development, from 2013 to 2018, known as China's Internet finance era. 2013 was the first year of China's Internet finance, and the launch of BalancePay in June of the same year made the online lending platform a well-known investment and financing method for consumers, and in this year China's first Internet assurance business (Zhongan Online) was accepted. In 2015, The concept of Fintech was introduced to the Chinese market, and at the same time, payment, lending, crowdfunding, intelligent investment, credit collection, and Internet insurance services were developing rapidly. In 2017, the State Council propelled a exceptional rectification of technology finance danger, and in 2018, the Central Bank, the Securities and Futures Commission and the Banking Regulatory Commission intervened in the administration of the technology finance industry to comprehensively strengthen the supervision of Fintech, to prevent and control financial risks, and to maintain the stability of Fintech.

### *3.3. Fintech 3.0 era*

The year of 2019 began to be known as China's Fintech 3.0 era, a stage in which technologies such as big data, artificial intelligence, blockchain, cloud computing, and 5G are deeply integrated with financial services. In August 2019, the People's Bank of China issued a Fintech development plan, which discusses the ideas about Fintech from various aspects, as a guide that can direct the development of Fintech in the future. In this 3.0 stage, China's Fintech is concerned more about technology application changes in different stages of business. This stage witnesses the combination between new technologies such as big data, artificial intelligence, blockchain, etc., and financial services to enable technology transformation, promote financial business innovation, and then highlight the scene application fine operation.

## **4. FINTECH REGULATION**

### ***4.1. The current situation of supervision in China***

First of all, China's financial regulatory model is lagging behind. The traditional regulatory model is to focus on rule-making, post-facto supervision, and regulatory indicators, instead of business actualization, risk prevention and data mining, which are priorities in new era. It is obvious that the regulation of fintech is based on data, but the root problem is the shortage of data and the incapability to recognize the authenticity of the data, so it cannot be controlled in an opportune style. As a consequence, significant reduction in regulatory efficiency arises. The unsoundness of the regulatory framework will lead to information asymmetry, which will be used by regulators to carry out arbitrage, harming the rights and interests of the people and increasing financial risks. At present, China's financial regulation is pursuing the regulatory concept of prior approval and post-event punishment, which cannot meet the innovative development needs of financial technology; And traditional financial dangers and technological risks are simple to be superimposed, principal the possibility of increased systemic risk. In addition, traditional financial regulation relies on the existing legal norms, regulatory techniques and means are unchanged. However, with the development of the times, Internet finance has evolved into a cross-border, mixed business model. This model will go in front of the sudden spread of risk and the spread of a spacious series of disadvantages<sup>[2]</sup>.

### ***4.2. The British sandbox regulatory system***

#### ***4.2.1. Background introduction***

Among the different international regulatory systems, the most worthy of our reference is the British sandbox regulatory system. The concept of "regulatory sandbox" was first proposed by the Financial Conduct Authority in November 2015 as a new regulatory strategy to encourage financial innovation while effectively controlling risks and reducing unnecessary regulatory barriers. Soon after the implementation of the regulatory sandbox system in the UK, more than 30 nations and areas including Australia and Singapore have promoted regulatory sandboxes and issued testing guidelines to build the corresponding institutional framework by comparing with their own development. More recently, regulatory authorities in Hong Kong, Thailand, Abu Dhabi and Malaysia have also launched their own regulatory sandbox programs.

#### ***4.2.2. Operation mode***

The enterprise submits an application to the

Financial Conduct Supervision Bureau, and conducts a regulatory sandbox operation test after passing the approval and access assessment. The enterprise that fails to pass must reapply. The test phase will last for three to six months. Any violations during this period will cause termination on test. If the test is successfully passed, a sandbox test report feedback will be generated. Those who fail the test result evaluation can choose whether to reapply according to their own circumstances. After passing the sandbox test, the enterprise can decide whether to go public or not.

#### ***4.2.3. Features of sandbox supervision***

Through the virtual sand table, appropriate relaxation of supervision allows innovative companies to discuss and solve the company's current problems with people in various fields without entering the real market, which can promote communication within the industry, achieve resource sharing, and enable innovative companies to have better development. The regulatory sandbox will also provide corresponding fault-tolerant solutions or assistance in accordance with the relevant conditions of the test enterprise's business and behavior, and provide targeted guidance.

### ***4.3. Regulatory recommendations for China***

#### ***4.3.1. Supervision mechanism***

There are four key points in Fintech regulation: whether the financial company has obtained the corresponding financial license, whether there is business outside of the scope; whether the regulatory authorities can match the risk control measures with the nature and level of risks they can undertake, and whether the new financial risks arising from a new technology can be predicted in advance. Among them, whether the risks can be predicted in advance can be solved through regulatory sandboxes. First of all, the chief physique of supervision should be clarified, and each department has a comprehensible division of labor and high cooperation to make certain the precise positioning, superintendence and recommendation for enterprises. Secondly, the authority should relax the access qualification, improve the interest of enterprises participating in sand table simulation and therefore introduce a large number of high-quality enterprises to achieve effective competition. In addition, attention should also be paid to maintaining the flexibility of regulation, relaxing the environment of enterprise simulation as much as possible without damaging the rights and interests of consumers, exploring diversified immunity channels, and making certain the innovation and vitality of enterprise development.

#### 4.3.2. Protection of consumer interests

First of all, we should fully introduce to consumers the operation mechanism of the virtual sand table and the possible potential risks in the operation process of the sand table, so as to protect consumers' legal right on awareness, privacy, independent choice and the right to ask for help. Secondly, efforts should be made to coordinate the relationship between enterprises and government departments, such as the relationship between enterprises and government agencies such as the Ministry of industry and information technology, the CSRC, the cbcirc and the Internet Financial Association, which is conducive to correcting errors and deficiencies in the process of enterprise operation<sup>[3]</sup>. At the same time, government departments can accurately grasp the information of enterprises and reduce the cost caused by information asymmetry.

#### 4.3.3. We will improve laws and regulations

China should enhance significant constitution and regulations and raise penalizing efforts. With the rapid development of the Internet, some criminals take advantage of the loopholes of the network platform, illegal fund-raising, stealing others' information and leading to pyramid selling fraud, etc. These behaviors destruct the rights and interests of the persons. Therefore, the regulatory authorities should strengthen the investigation and punish severely if found. First of all, our country should unify regulatory standards, rectify the regulatory system. Although the nation is the implementation of industry supervision system, the business is compound. It is hard to do all-round supervision, so some people use information asymmetry to arbitrage. Therefore, the authority should form a single sector regulation, gradually transition to multi-industry integration regulatory methods to enhance regulatory efficiency and reduce regulatory loopholes. In addition, China should clearly regulate the overall coordination organization of the sandbox, increase the information exchange among various departments, realize resources, data sharing, coordinate the preferential policies in various regions, and avoid malicious competition. Besides, improving the information disclosure and compensation channels, building a data sharing platform are essential for achieving information openness and transparency.

## 5. CONCLUSION

While financial technology is widely used in third-party payment, online lending, wealth management and other related fields, it has also derived some risk control problems. Through the analysis of the development process of China's financial technology and the regulatory problems in the development process, this paper finds that China's traditional regulatory model

cannot match the model of cross-border mixed operation of the Internet, Therefore, it is impossible to predict the risk, which is easy to lead to risk diffusion and risk superposition, which is not conducive to the development and progress of China's financial science and technology. Based on the reference of the British regulatory sand table, this paper puts forward some suggestions on China's financial technology regulation from the three aspects of regulatory mechanism, protection of consumers' interests and improvement of laws and regulations, so as to relax the sandbox simulation access qualification and improve the enthusiasm and innovation of enterprises; Strengthen the communication between various regulatory departments and enterprises to reduce the risk caused by information asymmetry. In short, under the condition of ensuring the activity of financial technology market, we should use appropriate ways to reduce the harm caused by risk according to China's national conditions.

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