



Legal Risks and Supervision of Internet Finance in China

Zhuoyu Zeng^(✉)

School of Law, Boston University, Boston, USA
zzeng@bu.edu

Abstract. In China, Internet finance is an emerging product of the Internet era. It provides an unprecedented development path for the traditional financial industry, but it also comes with new challenges. In many challenges, legal risk cannot be ignored. At present, relevant departments need to pay attention to how to identify risks and avoid them before they occur at the regulatory level. Only by establishing and perfecting the regulatory legal system, cultivating the risk prevention awareness of Internet consumers in their daily lives, and taking into account the efficiency and fairness of the financial market, can we promote the sustainable development of Internet finance.

Keywords: Internet Finance · Legal Risk · Supervision · P2P

1 Introduction

In recent years, with the rapid development of Internet technology, all walks of life began to show a trend of digitization, convenience and lightweight. Among them, the financial industry, as an industry that has long relied on electronic information technology, is more in line with the trend of the times, bringing the concept of Internet finance to the forefront of people's minds. In China, Internet finance is currently in the development stage. The legal supervision of Internet finance is not in place, and the existing laws and regulations conflict with Internet finance business, which makes Internet finance face great legal risks [1]. Therefore, taking the discovery of potential legal risks of Internet finance as the starting point, improving laws and regulations at the regulatory level, so as to create a healthy and regulated industry environment and protect the interests of consumers and investors, is the way to ensure the flourishing of Internet finance.

2 Overview of Internet Finance

2.1 Concept of Internet Finance

Internet finance is an emerging financial model that realizes the financing, payment, and information intermediary services with the help of Internet technology and mobile communication technology. It is different from indirect financing of commercial banks and

direct financing of capital market. Based on Internet information technology and with the aid of the Internet platform like cloud computing, big data technologies, Internet finance organically combines the financial industry to create new industry and multifunctional financial services include financial markets based on network platforms, services, organizations, products, and financial regulatory system. Additionally, Internet finance has formed a diversified financial model that is different from traditional finance. Although it has the advantages of high efficiency and low cost, it is also accompanied by huge financial risks [2].

2.2 Types of Internet Finance

2.2.1 Payment and Settlement

Payment and settlement can be furtherly divided into two types, one is an independent third-party payment platform and the other is a platform with mobile shopping and payment functions. Third-party payment platforms can meet people's payment settlement needs, such as WeChat Pay, a representative of third-party payment platforms in China. Unlike third-party payment platforms, the second type of platform is based on the development of shopping websites, such as Alipay, which originated from Taobao, the most popular online shopping website in China [3].

2.2.2 Financing

The most common type of financing function is P2P (peer to peer). P2P provides a platform for investors to lend their money to those who need to borrow without the need for an intermediary. Some typical examples are crowdfunding website and micro-loan platform. Crowdfunding is the use of the Internet by companies or individuals to attract those interested investors to fund their projects. In China, Renren, Jingdong and Alibaba are representatives of the many crowdfunding platforms. Since crowdfunding platforms started late and have much room for development, they will face more fierce competitions in the future. Micro-loan platform is the mode that combines e-commerce with micro-loan. One of the examples in China is the Alibaba micro-loan platform, which uses consumer's credit rating data shared by Alibaba shopping website to create an information database that effectively reduces the cost of credit ratings.

2.2.3 Investment

The investment function of Internet finance refers to the purchase of insured financial products by investors on Internet platforms to preserve and increase the value of their assets. Those financial products include fund, national debt, insurance, bank finance, foreign exchange and other products. One example is Alibaba's Yu Ebao, which is a money fund that people purchase through Alipay to ensure yield and liquidity [4].

2.2.4 Service Platform

Service platform could help individuals compare financial products and select those that are more suitable for consumers and offer higher yields.

2.3 Characteristics of Internet Finance

Internet finance has brought a huge impact to the traditional financial industry, which is mainly due to the following characteristics of Internet finance.

First, the transaction cost is very low. Under the mode of Internet finance, the supply and demand of funds can complete information screening, matching, pricing, and trading on their own through the online platform, without traditional intermediary, transaction cost and monopoly profit.

Second, high efficiency. Internet financial services are mainly handled by computers, and the operation process is completely standardized. Customers do not need to wait in line with faster business processing speed and better user experience. For example, Alibaba's micro-loan relies on the credit database accumulated by e-commerce, and after data mining and analysis, introduces risk analysis and credit survey model. Merchants can complete 10,000 loans in just a few seconds a day on average from application to disbursement. Internet finance makes it a real "credit factory" [5].

Third, Internet finance has a wide coverage. Under the mode of Internet finance, customers can break through the restrictions of time and geography to find the financial resources they need on the Internet. Financial services are more direct and the customer base is broader.

Fourth, the application of Internet finance grows rapidly. In China, based on the development of big data and E-commerce, Yu Ebao has attracted more than 2.5 million users and transferred 6.6 billion yuan in funds in 18 days after its launch. Nowadays, Yu E Bao has become the largest publicly offered fund with a scale of 50 billion yuan.

3 Legal Risks of Internet Finance

Although the characteristics of Internet finance have brought unprecedented vitality and unlimited space for development to the traditional financial industry, it has also brought new challenges to legislators and regulators. As is known to all, the law lags behind. Facing the emerging things of Internet finance, Chinese law has not yet fully regulated and supervised it. The legal risks brought by Internet finance can be divided into the following aspects.

3.1 Lack of Legal Supervision of Internet Finance

Although there are many laws and regulations in China regarding the regulation of the financial industry, most of them are aimed at the traditional finance industry rather than Internet finance. With the rapid growth of Internet finance, the Chinese legislative department has also issued some laws on online banking management, e-banking business management and anti-money laundering, but these laws are inherently conflicting [6]. For example, there is a lack of regulation about market access mechanisms of Internet finance. Equity-based crowdfunding on Internet financial platforms is popular, but this mode is not recognized by Chinese laws and regulations and can be considered illegal fundraising. At the same time, the lack of laws and regulations on whether business licenses are required to open Internet banks can easily lead to chaos in the industry. Therefore, in the field of Internet finance, the access mechanism of the market is seriously lacking, which is prone to legal risks [1].

3.2 Legal Risk on Civil Law Subjects of Internet Finance

The civil law subjects of Internet finance include Internet finance operators, investors and consumers. These subjects are facing different kinds of legal risks in their daily transactions. For example, operators are usually in a strong position that they can make use of the convenience of Internet finance platform to obtain various information about natural and non-natural consumers, while consumers' access to information can only depend on what operators disclose to the public. This gives rise to the risk of information asymmetry. In P2P online lending, P2P operators hide some core information or even provide misleading information for selfish reasons, resulting in investors being at a disadvantage in business operations and information collection [7].

In addition, there is also a legal risk that consumers' personal information will be violated when they use Internet financial services. If there exists deficiency in the internal control of Internet finance operators or other third-party company, this can easily lead to consumers' personal information being controlled by illegal elements, which in turn can lead to serious information leakage incidents.

3.3 Legal Risk on the Database of Internet Finance

The legal risk of Internet financial database is mainly focused on how to protect the data well. Internet finance is developed with the development of Internet technology, so there is a large amount of data to be processed, and any improper operation may cause data loss. Once the database is hacked, computer viruses, or encounters unstable data transmission, it will make it difficult to verify real data and increase the difficulty of judicial forensics.

4 Supervision of Internet Finance

Although China has developed some financial regulatory rules that clearly define the risks of Internet financial products, the standards and forms of adequacy, integrity and risk indication are not fully defined. If regulation of the Internet finance industry is not in place, the guaranteed system provided by online finance companies will lack reliability. Even if the risks to be borne by investors are clearly defined, it will not be a reasonable solution to the crisis of Internet finance. Therefore, we must pay attention to the supervision of online finance and optimize the relevant legal system [8].

4.1 Perfecting the Laws and Regulations for Internet Finance

During the growth of Internet finance, the relevant legal system is still not perfect, so it is necessary to continuously improve the relevant legal system, because the legal system can protect the development of Internet finance to a certain extent, and people can also be protected in the market transaction [9]. In China, although the Internet Finance Supervision Law, E-commerce Law and Cyber Security Law and other documents have been introduced one after another, there is still a lack of a more authoritative and legally effective legal system. To build a sound regulatory legal system, China's legislature

can draw on the rich experience of foreign countries and formulate laws and regulations according to the actual situation in China, as well as management methods and guidelines for specific businesses such as crowdfunding and third-party payment business.

4.2 Improving the Legal Supervising System of Internet Finance

On the basis of strengthening legislation and standardizing the legal system, a perfect Internet financial supervision system should be established [10]. On the one hand, the regulatory responsibilities and regulatory concepts of regulators should be established and improved. On the other hand, a comprehensive regulation of Internet financial business should be carried out before and during, i.e., the whole process of regulation. An effective coordination and linkage mechanism should be established. The qualification of platforms should be regularly reviewed to ensure that platforms are regular, safe, and free from illegal fund flows avoid cheating investors running away.

4.3 Improving the Risk Prevention Ability of Internet Financial Consumers

In addition to perfecting regulations and setting high and strict industry standards, attention should be paid to the publicity and education functions of the law. Although China has introduced a variety of laws and regulations to protect the rights and interests of consumers, the definition of consumers does not include the consumer groups with the purpose of investment income, which makes it difficult for financial consumers to get legal protection and brings great obstacles to the publicity of legal knowledge. Therefore, relevant government departments need to properly guide and regulate consumers' transactions in Internet finance, and promptly include some trust-breaking personnel into the credit system and constantly improve the current social credit investigation system, so as to greatly reduce the risks of consumers in the actual transaction process.

5 Conclusion

Internet finance is a new financial industry that emerged in line with the trend of the times. For this emerging industry, we should not only adopt an inclusive and supportive attitude to encourage innovative development, but also identify potential risks in a timely manner and formulate countermeasures as soon as possible to ensure the coordinated development of regulation and innovation, efficiency and equity. Internet finance has impacted the traditional financial industry, changed the traditional transaction methods, and promoted the improvement of economy. However, at the same time, Internet finance has also brought new pressure to the regulatory authorities. Therefore, only by correctly preventing risks and improving and solving the problems of Internet financial supervision can we promote the high-quality development of the social economy.

References

1. Mingyuan Gao, Analysis and consideration of legal risk of Internet finance, in: *Business & Economy*, 2020(02), pp. 180–182. DOI: <https://doi.org/10.19905/j.cnki.syjj1982.2020.02.067>

2. Weiteng Tao, Research on Legal Prevention and Control of Internet Financial Risks -- Comment on Internet Financial Law and Risk Control, in: *Journalism Lover*, 2020, No. 506(02), pp. 107–108.
3. Mingyu Liu, Qiannan Ma, Xin Wen, Risk and prevention and control of campus Internet loan, in: *Journal of Liaoning Institute of Educational Administration*, 2020, v. 37, No. 271(02), pp. 101–104.
4. Lei Guo, Legal problems and solutions of P2P online lending platform in China, in: *Legality Vision*, 2020, No. 808(20), pp. 175–176.
5. Xiaoyun Fan, Lanbiao Liu, Mengyi Yuan, *Internet Finance*, Beijing Book Co. Inc., 2016, p. 231.
6. Yan Zhang, Analysis and consideration of legal risk of Internet finance, in: *New Silk Road Horizon*, 2021(09), pp. 49–50.
7. Huiting Liu, Analysis and consideration of legal risk of Internet finance, in: *Business & Economy*, 2022(03), pp.178–179. DOI: <https://doi.org/10.19905/j.cnki.syjj1982.2022.03.058>
8. Zhiqing Zheng, Research on the Importance of Internet Financial Supervision and related legal issues, in: *Legality Vision*, 2021(26), pp. 85–86.
9. Yiman Jin, Research on Legal Issues of Internet Finance Supervision, in: *Quality & Market*, 2021(21), pp. 115–117.
10. Kaiwei Chen, Research on Legal Issues of Internet Finance Supervision, in: *Market Observer*, 2020(10), p. 29.

Open Access This chapter is licensed under the terms of the Creative Commons Attribution-NonCommercial 4.0 International License (<http://creativecommons.org/licenses/by-nc/4.0/>), which permits any noncommercial use, sharing, adaptation, distribution and reproduction in any medium or format, as long as you give appropriate credit to the original author(s) and the source, provide a link to the Creative Commons license and indicate if changes were made.

The images or other third party material in this chapter are included in the chapter's Creative Commons license, unless indicated otherwise in a credit line to the material. If material is not included in the chapter's Creative Commons license and your intended use is not permitted by statutory regulation or exceeds the permitted use, you will need to obtain permission directly from the copyright holder.

