

Research on Risk and Prevention of Internet Finance

Taking Yu'E Bao as an Example

Benyao Sun
Zaozhuang University
Zaozhuang, China

Abstract—With the continuous advancement of the times, people's living habits and consumption patterns are undergoing tremendous changes. The personal property investment has also changed from bank savings to Internet financial products with "Yu'E Bao" as a typical example. This paper firstly summarizes the existing Internet financial risk research results, and then analyzes the booming process of Internet finance and Yu'E Bao and their innovations in depth, analyzes the risks in the development of Yu'E Bao, and discusses the prevention and control measures for Internet financial risks.

Keywords—Internet finance; Yu'E Bao; risk prevention and control

I. INTRODUCTION

Internet finance appears in Western countries earlier than in China. However, the time disadvantage does not hinder its speed of development. In June 2013, Yu'E Bao began to operate. Within 30 days, there were 2.5 million users, and the total investment of users exceeded 6.6 billion yuan. After six months, the number of Yu'E Bao users increased by 16 times compared with the previous one, reaching forty and three million people. The scale of Yu'E Bao has also increased by 27 times, and the total investment of users is about 185.3 billion yuan. All kinds of data are amazing, which also fully shows the rapid development of Yu'E Bao. The rapid development of Yu'E Bao has attracted many relevant institutions to follow, and similar fund products are increasing day by day. The Internet finance industry has entered a stage of rapid development. With the accelerated development of Internet finance, its corresponding risks have become more and more prominent. The emergence of financial risks has caused the "Yu'E Bao" yield to decline from 6% at the beginning to 4%. The fund flow of individual enterprises is slow, which can not meet the needs of users, and even cause the company's capital chain to be interrupted. Company closures and making off with money have occurred from time to time, and the number of unqualified institutions has increased geometrically. Due to the imperfect credit information system, the backwardness of the technical level, the lack of supervision by relevant departments, and the blind follow-up of investors, the losses of investors are serious, and the prevention and control of financial risks cannot be ignored.

A. Research on Internet Finance Business and Development

Chen Jinyan (2013) believes that the practice of setting up an independent financial platform by financial institutions such as Alipay has revolutionized the modern business model [1]. Xu Liang (2014) believes that the reasons for the rapid development of Yu'E Bao are as the followings. First, Alipay has strong support for it. Second, Yu'E Bao has the characteristics of high income and low risk. Third, Yu'E Bao pays attention to the user experience. Fourth is the first issue of Yu'E Bao. These advantages have led to the high development rate of Yu'E Bao, which has had a profound impact on the development of China's overall economy [2].

B. Research on Internet Financial Risks and Prevention

Zhao Cheng (2014) made a detailed analysis of the differences between the profit model of Internet finance and the traditional financial model, pointed out the innovation of its profit model and the regulatory risks that the innovation lacks, and put forward relevant suggestions for its risk [3]. Pan Jing (2013) clearly pointed out that third-party payment companies in the Internet era should not only pay attention to the user's sense of use and operation, but also pay attention to the value of mobile Internet [4]. Li Heng and Hao Guogang (2014) believed that the high rate of return on Internet finance must be accompanied by high risks. The risk sources of Yu'E Bao are mainly in the following aspects. The first is the risk at the regulatory level, and the second is the risk from the bank. The third is the risk of Yu'E Bao. For such risks, the enterprises should unified industry access principles, strengthen industry supervision, establish and improve financial credit systems, strengthen the prevention and control of risks [5].

II. OVERVIEW OF INTERNET FINANCE AND YU'E BAO

A. Overview of Internet Finance

Internet finance refers to a mode of using the Internet to conduct transactions on the basis of traditional business. The emergence of Internet finance adapts to the development of financial markets.

The main role of Internet finance business is to provide financial services to users. It not only meets people's growing investment needs, but also reduces the intermediary costs of both transaction parties, and further strengthens the

liquidity of social funds. On the one hand, Internet finance uses the network platform to handle business, which greatly saves time for both parties. On the other hand, the application of the network platform slowly eliminates the traditional intermediary agencies, which improves efficiency and reduces transaction costs for both parties.

B. Overview of Yu'E Bao

1) *The generation of Yu'E Bao:* Yu'E Bao was born in June 2013. It was well received by people at the beginning, and it raised a large amount of funds in a short period of time, which has caused great impact on the traditional financial industry. The business function of Yu'E Bao is to invest the customers' spare money in wealth management products to obtain the corresponding profits. Users only need to transfer the remaining assets to Yu'E Bao, which is equivalent to purchasing the default wealth management products. It is very convenient and fast. Since the capital flow of Yu'E Bao is two-way, the user can use the funds in Yu'E Bao anytime and anywhere. The interest is calculated on a daily basis, and the users won't lose much money.

2) *The development status of Yu'E Bao:* Yu'E Bao is a financial product created by the Ali Group to meet the investment needs of its customers. As long as the funds enter Yu'E Bao, it is equivalent to purchasing the default fund, and the users will take the risk while obtaining the corresponding profit. With the strong support of Alipay, Yu'E Bao has made rapid development. The Ali Group has a third-party payment license. With Alipay's huge user resources, it does not take much time to have large-scale cash inflows and customer support. Second, the use of the funds of Yu'E Bao is not restricted by time and space. Users can use the funds in Yu'E Bao anytime and anywhere. Third, the access threshold of Yu'E Bao is low. To be exact, there is almost no threshold. Users can invest any amount to facilitate the user. At the same time, it also increases the earnings of users' idle funds.

In China, the largest third-party payment platform is Alipay, and more than 100 million users are using Alipay. The development of Yu'E Bao has a great impact on the Ali Group and even on China's overall economy. The target customers of Yu'eobao and Alipay are the same, and are all small-amount investors. Therefore, Yu'E Bao uses Alipay's huge users and data resources to attract a large number of small-amount investors to make the investment in a short period of time. In this process, Yu'E Bao makes profits by charging the fund management fee, technical service fee and other series of expenses. The profit model not only meets the investment needs of the target customers, but also makes Yu'E Bao get the corresponding profit, achieving a win-win situation for both parties. At the end of 2015, Yu'E Bao built an empire with the capital over 600 billion in two years.

With the development of Yu'E Bao, it can lend large-scale capital to individuals or enterprises with good credit, or find companies with better prospects to make the investment, and then obtain great profits. The safest measure is to negotiate with banks. By putting funds into the society

through the bank, not only can the relationship with the bank be improved, but also the win-win situation for itself, and the bank and the society is achieved.

III. THE FINANCIAL RISK IN THE INTERNET MODEL — TAKING YU'E BAO AS AN EXAMPLE

Yu'E Bao is essentially a financial product. Like other financial products, the amount of profits depends on the market interest rates. Therefore, the risk of Yu'E Bao is objective. The risks can be roughly divided into the following five parts. The first is credit risk, the second is operational risk, the third is liquidity risk, the fourth is legal risk, and the fifth is policy and regulatory risk. We can't just pay attention to high yield of Yu'E Bao, and ignore the risk. It is necessary to strictly examine the credit status of users, improve the financial quality of users, retain reserve funds, and strengthen the supervision. Only in this way can the risk of Yu'E Bao be fundamentally reduced.

Taking Yu'E Bao as an example, Internet finance mainly has the following five aspects of risks.

A. Credit Risk

Most people don't know about Yu'E Bao comprehensively. They think that Yu'E Bao is a management tool of money funds. Its corresponding risk is relatively small. However, Yu'E Bao is not out of the risk-return scope, and the yield of Yu'E Bao is high. In fact, it is caused by the high risk of money fund investment. If you want to obtain greater profits, you must bear higher risks. Therefore, the credit risk of Yu'E Bao is objective. Yu'E Bao users only know about bank interest rates and don't know about professional financial management. Therefore, Yu'E Bao's interest rate higher than that of banks attracts the attention of these users. Higher interest rates also make them ignore credit risks. Yu'E Bao easily raise the funds of these users. Under this financial model, financial risks will continue to accumulate, and problems will arise in the later stages. The credit risks will continue to emerge.

B. Operational Risk

The operational risk of Yu'E Bao has the following aspects.

The practitioners are not strong enough. The investors blindly pursue the maximization of interests, ignore the moral bottom line, and disregard professional ethics. If there is no effective supervision of the investment process, it will easily make some practitioners, especially senior management personnel, deliberately break the law.

Investors collude with bank staff and internal financial personnel to disclose commercial and state secrets, and illegally trade customers' funds for personal gain, causing capital losses to users and enterprises.

The operator blindly pursues higher interests and lacks rational thinking, which leads to misjudgment of the financial market and ultimately causes serious property losses.

The internal error of the Internet system or hacking intrusion will cause the risks. The Internet financial system has high requirements for computer technology and Internet technology. However, some financial institutions in China outsource the entire Internet system to related enterprises. Then, the supervision on their own system is not in place, and many risks arise.

C. Liquidity Risk

Alipay is the basis for the production of Yu'E Bao. Tianhong Asset Management is the basis of Alipay. Since the funds of Yu'E Bao are to meet the shopping needs of users anytime and anywhere, this requires Tianhong Asset Management to have stable liquidity fund, and the users of Yu'E Bao can always withdraw the funds. Otherwise, Tianhong Asset Management will have losses on the assets. Yu'E Bao has some unilateral propaganda, over-promoting its high-yield, but there is very little publicity about risk. For the large-scale financial institutions such as Yu'E Bao, in order to meet the liquidity needs of users, its main funds still should be used at bank agreement deposit. In June 2013, the severe shortage of funds in the financial market is a true portrayal of the objective existence of liquidity risk.

After the scale of the funds of Yu'E Bao has reached a certain level, the fierce market competition will also intensify the pressure on the management of liquidity. Due to the strong liquidity of user demand and the limited liquidity of Yu'E Bao, it will not be able to satisfy users to withdrawal a large amount of cash in a short period of time. The profits of Yu'E Bao must be obtained after the fund closing. Therefore, Ali Group needs to pay a portion of the funds in advance, which makes Alipay bear the corresponding liquidity risk. That is to say, the healthy liquidity of the money fund is crucial for Yu'E Bao.

D. Legal Risks

Taking Yu'E Bao as an example, Tianhong Asset Management believes that Yu'E Bao is only a financing product. However, it is essentially the fund product. Alipay obtained the fund payment license in 2012. Due to the absence of specific provisions of relevant laws and regulations, Alipay conducted fund sales without permission. If Tianhong Asset Management invests the funds of Yu'E Bao in other companies, it is easy to generate legal risks without corresponding legal and regulatory restrictions. Yu'E Bao's evasion of legal risks can be seen from its explanation of user losses. When a dispute arises, Yu'E Bao can use this clause to shirk responsibility in most cases.

E. Policy and Regulatory Risks

The policy and regulatory risks of Yu'E Bao have always been accompanied by its development. In March 2013, Zhou Xiaochuan (2013), the governor of the People's Bank of China, said that the country would not ban Yu'E Bao, but will continue to improve the regulatory policies for the financial business such as Yu'E Bao. For example, due to the rule of the "advance withdrawal without penalty interest" in the agreement contract of Yu'E Bao, the CSRC has relaxed the capital restrictions on Yu'E Bao. Once Yu'E Bao

modifies this regulation, the user will lose interest by withdrawing funds in advance. Then, before such policies are officially issued, the policy risks of Yu'eobao will be caused.

The settlement account and reserve account of Yu'E Bao are separately supervised by the China Securities Regulatory Commission and the People's Bank of China. However, the funds of Yu'E Bao can be freely flowed between the two accounts. It doesn't clearly define the regulation of liquidity fund. All of China's deposit business is managed by the central bank, but the funds transferred by Yu'E Bao are not within the scope of the central bank's supervision. Without supervision of this part of the funds, it will inevitably lead to the emergence of risks. Some criminals use the supervision loophole of Yu'E Bao to make illegal activities such as money laundering, tax evasion and illegal transactions. Therefore, the policy and regulatory risks of Yu'E Bao are objective.

IV. PRECAUTIONARY MEASURES OF INTERNET FINANCIAL RISK

A. Accelerating the Construction of Credit System to Reduce Credit Risk

The Internet financial credit system can't be established by relying on the government alone. The government, enterprises and individuals should share information and establish a big database of credit information. We can learn from the advanced practices of Western countries, and establish a complete social financial credit system, including credit evaluation, credit inquiry, credit registration and other aspects of services. It serves all enterprises, individuals and the government. Scientific and unified credit evaluation standards are implemented nationwide, and credit information is open and transparent. Only in this way can the credit evaluation results be widely recognized by the society. The government, enterprises and individuals can trust each other, and the Internet finance business can be further developed. Yu'E Bao do well in this aspect. Yu'E Bao has its own independent credit evaluation and management system, namely Zhima Credit. Zhima credit is a personal credit evaluation established by Alibaba Group based on various aspects of information, especially based on users' current work and previous consumption habits using Alipay. Through data analysis, personal credits are displayed in the form of numbers. The credit is high, and the score is high, making the credit information more intuitive.

B. Improving Internet Information Technology to Reduce Operational Risks

Infrastructure such as computers is closely related to the security of Internet finance. If there are defects in hardware facilities such as computers, operational security issues cannot be avoided. Therefore, it is necessary to strengthen the construction of infrastructure such as computers. At present, there is still a big gap between China's computer technology and that of Western countries. The backwardness of computer technology has caused the security problems of China's Internet finance to emerge endlessly, which has

seriously hindered the development of China's Internet finance. Therefore, we must speed up the research on computer technology, and apply the research results to Internet finance as soon as possible. Based on the national conditions, we must continue to innovate while absorbing foreign advanced experience. Only in this way can the operational risk of Internet finance be fundamentally eliminated, and Internet finance can develop healthily and steadily.

C. Establishing a Full-time Team to Cooperate with Many Parties to Reduce Liquidity Risk

Nowadays, Internet finance professionals are in short supply. Workers in the traditional financial industry cannot be qualified for Internet finance due to the lack of computer knowledge. However, workers in the computer industry lack financial knowledge and can not be competent. This will affect the professionalism of financial system construction. Therefore, it is necessary to cultivate professional talents in the Internet finance industry and establish a professional Internet finance team to ensure the scientific improvement of the financial system, so as to effectively prevent and control the flow risks.

D. Strengthening the Construction of Legal System to Reduce Legal Risks

First of all, we must improve the corresponding legal framework as soon as possible, supplement the traditional financial laws and regulations according to the development and innovation of Internet finance, and clarify the central bank's position as the main body of monetary supervision and make up for its loopholes in Internet financial supervision. Secondly, it is necessary to introduce the professional law of Internet finance as soon as possible, screen the participants of Internet finance, ban the financial institutions that do not meet the requirements, and purify the main environment of the financial market. It is necessary to promptly introduce laws and regulations that clarify the responsibilities of relevant departments, and their regulatory rights and obligations have a legal basis, which will reduce the supervision gap and mutually making excuses among related departments, thereby reducing the legal risks of Internet finance.

E. Improving Internet Finance Policies and Strengthening Supervision

Internet finance is the product of the financial industry confirming to the requirements of the times. Its important role is not only recognized by the government, but also supported by the government. For the supervision of Internet finance, relevant departments must fulfill their duties, such as strengthening the supervision of the remaining funds of Alipay users, supervision of relevant laws and regulations, supervision of Alipay users' sources of funds and usage, and internal supervision of Internet finance, etc. For the problem of regulatory gaps in some areas, the relevant departments may set up temporary supervision institutions to ensure the comprehensiveness of Internet financial supervision before having clear stipulation.

V. CONCLUSION

Internet finance is a product of the financial industry conforming to the trend of the times. It provides users with corresponding financial services based on the Internet, but it still belongs to the financial industry. Yu'E Bao is the most comprehensive among Internet financial products, and exists for the longest time. Therefore, the research on its risk can be extended to the research on whole risk of the entire Internet finance. According to the actual situation of Yu'E Bao, we should make up for the shortcomings of Yu'E Bao, use Alipay's huge resource support to prevent and control risks.

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