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Regulation of Digital Financial Services in China:

Last Mover or First Mover?

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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.

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1. 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.¹

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 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-

¹ See D. Arner, J. Barberis & R. Buckley, “FinTech: A New Post-crisis Paradigm?” (Sep. 2015).

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 2 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 which 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 3 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*² (2015 DFS Guideline). The Guideline clarified a number of important issues and addressed various types of DFS. Further, the

² *Guan Yu Cu Jin Hu Lian Wang Jin Rong Jian Kang Fa Zhan De Zhi Dao Yi Jian (Guideline on the Promotion of the Health Development of Internet Finance)*, promulgated on 18 July 2015. The Chinese official version of the Guideline is here: http://www.mof.gov.cn/zhengwuxinxi/zhengcefabu/201507/t20150720_1332370.htm

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 4 and 5 thus offer a comprehensive study and analysis of China's regulation of DFS by discussing, respectively, China's DFS regulations before 2015 (section 4) and the 2015 DFS Guideline (section 5). 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 6 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.

2. 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.³

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 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 mainly operated to supplement the lending activities of the “Big Four” with a focus on areas (such as rural areas) and borrowers

³ 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” (2002)28(10) *Managerial Finance* 3-18 at 4-5; Franklin Allen, Jun Qian & Meijun Qian, “China's Financial System: Past, Present, and Future” in Loren Brandt & Thomas G. Rawski (eds) *China's Great Economic Transformation* (New York: Cambridge University Press, 2008) 506-568 at 509-511; Patrick Hess, “China's Financial System: Past Reforms, Future Ambitions and Current State” in F., Rövekamp & H.G., Hilpert (eds) *Currency Cooperation in East Asia* (Springer, 2014) 21-41 at 25-29; Peter Sparreboom & Eric Duflos, “Financial Inclusion in the People's Republic of China: An Analysis of Existing Research and Public Data”, CGAP and Working Group on Inclusive Finance in China, China Papers on Inclusiveness No.7 (August 2012) 1-45. 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* (Washington D.C.: Brookings Institution Press, 1998).

(such as non-state owned enterprises) with limited access to the state-owned banks.⁴ 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.⁵ 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).⁶

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 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.⁷ Investment and loan policies in favour of SOEs remained in place.⁸ As a result,

⁴ See above n 3, Lardy, *China's Unfinished Economic Revolution*, at 61-76.

⁵ See above n 3, Sparreboom & Duflos, "Financial Inclusion in the People's Republic of China", at 7-8. For a discussion of China's interest rate policy reforms during this period, see Alexander Ballantyne, Jonathan Hambur, Ivan Roberts and Michelle Wright, "Financial Reform in Australia and China", Reserve Bank of Australia Research Discussion Paper 2014-10, 1-42 at 23-25.

⁶ See above n 3, Lardy, *China's Unfinished Economic Revolution*, at 76-127; Sparreboom & Duflos, "Financial Inclusion in the People's Republic of China", at 8.

⁷ See above n 3, Sparreboom & Duflos, "Financial Inclusion in the People's Republic of China", at 9.

⁸ *Ibid.*, at 10.

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.⁹

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.¹⁰ 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 2016.¹¹ Second, the Chinese government continued to liberalize China's exchange rate regime which led to significant and steady appreciation of the RMB.¹² 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.¹³ 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".¹⁴ 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.¹⁵ Further, various new types of microfinance emerged and developed in this period such as P2P lending, microcredit companies, village banks, etc.¹⁶ 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".¹⁷ 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

⁹ Ibid., at 10-11.

¹⁰ See above n 3, Hess, "China's Financial System: Past Reforms, Future Ambitions and Current State", at 28-29.

¹¹ See above n 5, Ballantyne *et al.*, "Financial Reform in Australia and China", at 30.

¹² See above n 5, Ballantyne *et al.*, "Financial Reform in Australia and China", at 33-34; Ross Buckley and Weihuan Zhou, "Navigating Adroitly: China's Interaction with the Global Trade, Investment, and Financial Regimes" (2014)9(1) *University of Pennsylvania East Asia Law Review* 1-40 at 32.

¹³ Richard Herd, Samuel Hill and Charles Pigott, "China's Financial Sector Reforms", OECD Economics Department Working Papers No.747 (ECO/WKP(2010)3), 1-46 at 1-11.

¹⁴ See above n 3, Sparreboom & Duflos, "Financial Inclusion in the People's Republic of China", at 13.

¹⁵ See above n 3, Sparreboom & Duflos, "Financial Inclusion in the People's Republic of China", 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, available at: <http://www.microfinancegateway.org/library/microfinance-china-0>

¹⁶ See Du Xiaoshan, "The Current Supply of Microfinance Services in China", World Microfinance Forum Geneva (January 2008), available at: <http://www.microfinancegateway.org/library/current-supply-microfinance-services-china>; above n 3, Sparreboom & Duflos, "Financial Inclusion in the People's Republic of China", at 21.

¹⁷ See above n 3, Sparreboom & Duflos, "Financial Inclusion in the People's Republic of China", at 12.

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.¹⁸ 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."¹⁹ In May 2015, the formal deposit insurance system was established.²⁰ 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 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.

¹⁸ 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)

¹⁹ See Financial Stability Analysis Group of the PBOC, "China Financial Stability Report 2015" (May 2015) at 31, available at: <http://www.pbc.gov.cn/publish/english/959/index.html>

²⁰ *Cun Kuan Bao Xian Tiao Li (Regulation on Deposit Insurance)*, promulgated by the State Council Decree No. 660 on 17 February 2015, effective on 1 May 2015. Chinese official version available at: http://www.gov.cn/zhengce/content/2015-03/31/content_9562.htm

In contrast with China's fast growing economy and increasingly deeper economic reforms, its financial system reforms have progressed much more slowly.²¹ 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, un-competitiveness 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.²² 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.²³

In respect of financial inclusion, despite the various policies promoting financial services coverage in underserved segments²⁴, the lack of financial inclusion is likely to continue given the bias of banks towards state-run companies and designated sectors.²⁵ 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.²⁶ 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 system in the future".²⁷ This will in turn propel China's transition to a market-based financial system and overall economic reforms and growth.²⁸

²¹ See above n 3, DaCosta & Foo, "China's Financial System: Two Decades of Gradual Reforms", at 3; Hess, "China's Financial System: Past Reforms, Future Ambitions and Current State" at 22; Lardy, *China's Unfinished Economic Revolution*, at 16-17.

²² See above n 3, Hess, "China's Financial System: Past Reforms, Future Ambitions and Current State" at 29-33.

²³ See above n 3, Allen, Qian & Qian, "China's Financial System: Past, Present, and Future", at 506.

²⁴ See, for example, above n 13, Herd, Hill & Pigott, "China's Financial Sector Reforms", at 27-32.

²⁵ See above n 3, Sparreboom & Duflos, "Financial Inclusion in the People's Republic of China", at 27-29.

²⁶ See He Guangwen, "An Analysis of Microfinance Demand in China", World Microfinance Forum Geneva (February 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>.

²⁷ See above n 3, Allen, Qian & Qian, "China's Financial System: Past, Present, and Future", at 531-532.

²⁸ See Joanna Ledgerwood, Julie Earne and Candace Nelson (eds), "The New Microfinance Handbook: A Financial Market System Perspective" (Washington D.C.: The World Bank, 2013) at 1-2. (Recognising various benefits of financial inclusion and its contributions to economic growth and stability)

3. 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.²⁹ Innovative forms of digital finance are being increasingly introduced in financial markets around the world.³⁰ 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.³¹ 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.³²

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.³³ Both deposit and lending interest rates were virtually fixed at levels significantly below market levels³⁴ 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.³⁵ 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 has provided a fertile ground for the growth of digital finance.³⁶ 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

²⁹ See, for example, Alliance for Financial Inclusion, “Digital Financial Services”, available at: <http://www.afi-global.org/policy-areas/digital-financial-services>

³⁰ See above n 29, “Digital Financial Services”; Kate Lauer & Timothy Lyman, “Digital Financial Inclusion”, CGAP (10 March 2015), at 1, available at: <http://www.cgap.org/publications/digital-financial-inclusion>

³¹ See Anita Gardeva & Elisabeth Rhyne, “Opportunities and Obstacles to Financial Inclusion: Survey Report”, Center for Financial Inclusion (2011), at 11-12, available at: <http://www.centerforfinancialinclusion.org/publications-a-resources/browse-publications/205>; above n 30, Lauer & Lyman, “Digital Financial Inclusion”, at 1.

³² See The World Bank, “Digital Finance: Empowering the Poor via New Technologies” (10 April 2014), available at: <http://www.worldbank.org/en/news/feature/2014/04/10/digital-finance-empowering-poor-new-technologies>

³³ See above n 5, Ballantyne *et al.*, “Financial Reform in Australia and China”, at 24-25.

³⁴ Bo Hu, “Financial Repression and Interest Rate Liberalization in China”, conference paper (April 2014), at 2, available at <https://economics.indiana.edu/home/conferences/2014-jordan-river-economics-conference/files/2014-05-02-05.pdf>

³⁵ *Ibid.*

³⁶ Tjun Tang, Yue Zhang & David He, “The Rise of Digital Finance in China: New Drivers, New Game, New Strategy”, The Boston Consulting Group (October 2014) at 5-6.

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.³⁷ 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.³⁸ 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.³⁹

3.1 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'.⁴⁰ Since then, China has been at the forefront of development of the ATM market.⁴¹ 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.⁴² By 2013, ATMs in China had soared to 520,000, making China the largest ATM market in the world.⁴³ In addition, 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.⁴⁴

³⁷ See Louise Malady & Ross Buckley, "The Regulation of Mobile Money in Emerging Markets: State of Play", research funded by CIFR, UNCDF, Standard Chartered Bank and UNSW, 30 April 2014, available at: <http://www.cimr.unsw.edu.au/resource/risk/regulation-of-mobile-money/regulatory-state-play-april-2014>

³⁸ See above n 30, Lauer & Lyman, "Digital Financial Inclusion", at 1-2.

³⁹ See above n 36, Tang, Zhang & He, "The Rise of Digital Finance in China", at 13-27.

⁴⁰ ResearchInChina, "China ATM (Automatic Teller Machine) Market Report, 2008", August 2008, at 1, available at: <http://www.researchinchina.com/FreeReport/PdfFile/633879276546958750.pdf>; Bank of China, "China's First ATM Card", available at: http://www.boc.cn/en/aboutboc/ab5/200811/t20081119_1602016.html

⁴¹ See above n 40, ResearchInChina, "China ATM (Automatic Teller Machine) Market Report, 2008", at 4.

⁴² See above n 3, Sparreboom & Duflos, "Financial Inclusion in the People's Republic of China", at 16.

⁴³ RBR, "China overtakes USA as world's largest ATM market", Press Release (20 June 2014), available at: http://www.rbrlondon.com/about/ATMs_China_2014_Press_Release_200614.pdf.

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

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 2002.⁴⁵ 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.⁴⁶ 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.”⁴⁷ 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.⁴⁸ In 2014, the increases were even more rapidly 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%), and RMB 16.21 trillion online payment transactions by payment institutions (a y-o-y increase of 75.5 percent).⁴⁹

Internet banking was introduced in China by the BOC in 1996, and quickly adopted by the other major state-owned and privately-owned banks between 1997 and 2002.⁵⁰ Since 2002, the number of internet banking users has increased rapidly.⁵¹ 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.⁵² In 2014, China Minsheng Bank, the largest privately-owned commercial bank in China, launched its Direct Banking platform to move all of its standardised bank products and transactions online.⁵³ Minsheng Bank’s entry into Direct Banking was quickly followed by the state-owned banks and other jointly-owned banks.⁵⁴ This signalled a historic move of China’s major banks into the digital finance era such that, predictions are now being made

⁴⁵ Arlyss Gease & Joan Qiu, “China 20/20: The Future of Mobile Payment in China”, Maverick China Research (December 2012), at 4, available at: <http://www.maverickchina.com/reports/china-20-20-whitepapers>

⁴⁶ Ibid. Also see China UnionPay, “Brief Review on the Development of China’s Payment System”, undated, available at: 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”)

⁴⁷ See Leesa Shrader and Eric Duflos, “China: A New paradigm in Branchless Banking”, CGAP (March 2014), at 37.

⁴⁸ See Financial Stability Analysis Group of the PBOC, “China Financial Stability Report 2014” (April 2014) at 116, available at: http://www.centerforfinancialstability.org/fsr/chn_fsr_201407.pdf

⁴⁹ See above n 19, PBOC, “China Financial Stability Report 2015”, at 123.

⁵⁰ Xina Yuan, “Present and Future of Internet Banking in China” (2010)15(1) *Journal of Internet Banking and Commerce* 1-10 at 3.

⁵¹ Ibid., at 4.

⁵² See above n 36, Tang, Zhang & He, “The Rise of Digital Finance in China”, at 32.

⁵³ See above n 36, Tang, Zhang & He, “The Rise of Digital Finance in China”, at 4.

⁵⁴ See Wu Hongyuran, “Minsheng Bank is Latest to Join E-Commerce Fray”, Caixin online (23 August 2013), available at: <http://english.caixin.com/2013-08-23/100573307.html>; Li Xiaoxiao & Liu Caiping, “Banks Trying Direct Route to Online Future”, Caixin online (22 January 2015), available at: <http://english.caixin.com/2015-01-22/100777224.html>

that “direct banks will take more than 10% market share of the retail banking industry (in China) by 2020”.⁵⁵

In addition, to promote the internationalization 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.⁵⁶ 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 2014.⁵⁷

3.2 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.⁵⁸ Riding the wave of the increasing adoption of new technologies⁵⁹, 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 group has developed many influential digital finance products.⁶⁰ The most significant are:

- Alipay⁶¹, 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

⁵⁵ See Hua Zhang, “China’s Direct Banks: Birth of a New Banking Sector”, CELENT (5 January 2015), available at: <http://www.celent.com/reports/chinas-direct-banks-birth-new-banking-sector>

⁵⁶ SWIFT, “RMB Internationalisation: Implications for the Global Financial Industry”, White Paper (2011), available at: http://www.swift.com/assets/swift_com/documents/products_services/RMB_White_paper_internationalisation.pdf

⁵⁷ Saikat Chatterjee & Tomasz Janowski, “Factbox: Development of China’s Yuan Payment Systems”, REUTERS (8 July 2014), available at: <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”, Media Release (19 November 2014), available at: <http://www.asx.com.au/documents/asx-news/asx-welcomes-bank-of-china-as-rmb-clearing-bank.pdf>

⁵⁸ Generally see above n 36, Tang, Zhang & He, “The Rise of Digital Finance in China”, at 1-11. For a more detailed overview of the development of DFS in China, see Financial Stability Analysis Group of the PBOC, “China Financial Stability Report 2014” (April 2014) at 171-176, available at: http://www.centerforfinancialstability.org/fsr/chn_fsr_201407.pdf

⁵⁹ See above n 47, Shrader & Duflos, “China: A New paradigm in Branchless Banking”, at 6-8. 15-17. For a comprehensive report on China’s internet coverage and digital development, see Jonathan Woetzel, *et al.*, “China’s Digital Transformation: The Internet’s Impact on Productivity and Growth”, McKinsey Global Institute (July 2014).

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

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

million registered users in China (and 17 million overseas)” by October 2014.⁶² It “handles more than 80 million transactions daily” and had settled 42.3 billion payments by December 2014.⁶³ 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”.⁶⁴

- AliFinance, one of the pilot financial products launched by Alibaba in 2011, provides micro-loans to vendors registered on Alibaba and TaoBao platforms.⁶⁵ 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).”⁶⁶ Although AliFinance’s market share remains marginal (i.e. around 0.1% of the total loans issued by China’s banks),⁶⁷ 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 aiming 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 Internet-based gender-finance program in China” on 27 January 2015 committing to “expand financing for women entrepreneurs”.⁶⁸
- 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

⁶² See Christina Larson, “Alipay Leads a Digital Finance Revolution in China”, MIT Technology Review (26 January 2015), available at: <http://www.technologyreview.com/news/534001/alipay-leads-a-digital-finance-revolution-in-china/>

⁶³ See Alibaba Group, “Alipay 2014 Spending Report Sheds Light on Chinese Online Spending Behavior”, Press Release (8 December 2014), available at: <http://www.alibabagroup.com/en/news/article?news=p141208>

⁶⁴ See Matthias Hendrichs, “Why Alipay is more than just the Chinese equivalent of Paypal”, TECHINASIA (3 August 2015), available at: <https://www.techinasia.com/talk/online-payment-provider-alipay-chinese-equivalent-paypal/>

⁶⁵ See above n 60, Shrader, “Microfinance, E-Commerce, Big Data and China: The Alibaba Story”. AliFinance’s official website is here: <http://view.1688.com/cms/info/loan/2010/xinxibaoguang/01.html> (in Chinese).

⁶⁶ See above n 60, Shrader, “Microfinance, E-Commerce, Big Data and China: The Alibaba Story”.

⁶⁷ Simon Rabinovitch, “Alibaba Digs Deep for Chinese Banking Treasure”, Financial Times (25 August 2013), available at <http://www.ft.com/intl/cms/s/0/f956b004-ffee-11e2-9c40-00144feab7de.html#axzz3emowunHf>.

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

generally much higher than those offered by banks.⁶⁹ Yu'e Bao does not require minimum deposits and allows withdrawal at any time.⁷⁰ 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.⁷¹ With these advantages compared to conventional financial products, Yu'e Bao has quickly become China's largest online money market fund⁷² and the fourth largest worldwide.⁷³ After only one year, Yu'e Bao had 100 million investors and RMB 570 billion (or more than \$90 billion) assets under management.⁷⁴

- 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.⁷⁵ 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.⁷⁶
- 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.⁷⁷ 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 institutions “to create a new financial ecosystem” in China.⁷⁸ For example, via its digital finance platforms, Ant Financial has successfully expanded digital financial inclusion in underdeveloped rural areas

⁶⁹ 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”, International Business Times (11 March 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).

⁷⁰ Ibid.

⁷¹ Ibid.

⁷² Ibid.

⁷³ See above n 36, Tang, Zhang & He, “The Rise of Digital Finance in China”, at 4.

⁷⁴ Ibid.

⁷⁵ Clifford Coonan, “China's Alibaba Launches Crowdfunding-Like Service for Film Investment”, The Hollywood Reporter (1 April 2014), available at: <http://www.hollywoodreporter.com/news/china-s-alibaba-launches-crowdfunding-692910>; Neil Gough, “Alibaba to Make Movies With Crowdfunding Idea”, The New York Times (26 March 2014), available at: http://dealbook.nytimes.com/2014/03/26/alibaba-enters-the-movie-business-with-a-kind-of-crowdfunding/?_r=0

⁷⁶ Ibid.

⁷⁷ See Alibaba Group, “Official Launch of Ant Financial Services Group Brings New Financial Ecosystem to China”, Press Release (16 October 2014), available at: <http://www.alibabagroup.com/en/news/article?news=p141016>.

⁷⁸ Ibid.

and has committed to continue to do so by building more digital finance infrastructure and channels in these areas.⁷⁹

- In June 2015, Alibaba opened its internet bank called MYbank to offer loans of up to RMB 5 million (or \$800,000) to SMEs.⁸⁰ 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.⁸¹ 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).⁸² Tenpay, Tencent's online payment product providing B2B, B2C and C2C payment services, is China's second largest online payment platform after Alipay.⁸³ 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.⁸⁴ Two days after its launch, the promotion attracted more than 5 million users exchanging over 20 million envelopes.⁸⁵ The digital "Red Envelope" carried on its success to the 2015 Spring Festival witnessing the exchange of 1 billion virtual red

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

⁸⁰ See The Australian, "China's Alibaba launches internet bank", 26 June 2015, available at:

<http://www.theaustralian.com.au/business/latest/chinas-alibaba-launches-internet-bank/story-e6frg90f-1227415805816>

⁸¹ Tencent's official website is here: <http://www.tencent.com/en-us/index.shtml>

⁸² Reuters, "China's Tencent hits \$200 billion market cap for first time" (13 April 2015), available at: <http://www.reuters.com/article/2015/04/13/us-tencent-valuation-idUSKBN0N40WN20150413>

⁸³ Vaseem Khan, "Alipay Vs Tenpay – The China Payments Rivalry", LTP (12 February 2015), available at: <http://letstalkpayments.com/alipay-vs-tenpay-the-china-payments-rivalry-2/>

⁸⁴ See Wikipedia, "WeChat Red Envelope", last modified on 29 March 2015, available at: https://en.wikipedia.org/wiki/WeChat_red_envelope

⁸⁵ See Josh Horwitz, "Chinese WeChat users sent out 20 million cash-filled red envelopes to friends and family within two days", TECHINASIA (5 February 2014), available at: <https://www.techinasia.com/wechats-money-gifting-scheme-lures-5-million-chinese-users-alibabas-jack-ma-calls-pearl-harbor-attack-company/>

envelopes on New Year's Eve and trumping Alipay in the "red envelope war".⁸⁶ 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".⁸⁷ 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%.⁸⁸ More recently 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.⁸⁹

Another example is Baidu, one of China's most famous web services companies that operates China's largest internet search engine.⁹⁰ In October 2013, Baidu launched its own online wealth management product called "Baifa".⁹¹ 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".⁹² While less popular than Yu'e Bao and WeChat, Baifa "reportedly raised USD 165 million from 120,000 customers on the day it launched".⁹³ In addition, Baidu has its own personal loan platform called Baidu Finance which allows customers to "borrow up to ten times their monthly income" with a flexible repayment term up to 3 years.⁹⁴ Loan applications and approvals are all processed online within as quickly as 5 minutes.⁹⁵ Most recently, Baidu launched another

⁸⁶ See David Yin, "Tencent's WeChat Sends 1 Billion Virtual Red Envelopes on New Year's Eve", *Forbes* (19 February 2015), available at:

<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", *Financial Times* (27 February 2015), available at: <http://www.ft.com/intl/cms/s/0/c39c96c6-be2a-11e4-8cf3-00144feab7de.html#axzz3eyf3RyLo>

⁸⁷ See above n 36, Tang, Zhang & He, "The Rise of Digital Finance in China", at 4.

⁸⁸ See Paul Bischoff, "WeChat leaps into banking, lets users set up online investment fund", *TECHINASIA* (16 January 2014), available at: <https://www.techinasia.com/wechat-leaps-banking-lets-users-set-online-investment-fund/>

⁸⁹ See Gabriel Wildau, "Tencent launches China's first online-only bank", *Financial Times* (5 January 2015), available at: <http://www.ft.com/intl/cms/s/0/ccc5a6dc-9488-11e4-82c7-00144feabdc0.html#axzz3f4JCnBsS>

⁹⁰ See Wikipedia, "Baidu", last modified on 18 June 2015, available at: <https://en.wikipedia.org/wiki/Baidu>

⁹¹ See Josh Horwitz, "Baidu announces upcoming launch of Baifa as it moves into personal finance", *TECHINASIA* (21 October 2013), available at: <https://www.techinasia.com/baidu-announces-upcoming-launch-baifu-moves-personal-finance/>

⁹² *Ibid.*

⁹³ Nisha Koul, "Chinese Internet Companies Alibaba, Baidu Offer Financial Services Through Subsidiaries Yu'e Bao, Baifa", *MicroCapital* (5 February 2014), available at: <http://www.microcapital.org/microcapital-brief-chinese-internet-companies-alibaba-baidu-offer-financial-services-through-subsidiaries-yue-bao-baifa/>

⁹⁴ Paul Bischoff, "Baidu rebrands online finance service, introduces loans", *TECHINASIA* (25 April 2014), available at: <https://www.techinasia.com/baidu-rebrands-online-finance-service-introduces-loans/>

⁹⁵ *Ibid.*

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.⁹⁶

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.⁹⁷ 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.⁹⁸ 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\$148m) in that year.⁹⁹ Most recently, Dalian Wanda Group, one of China’s largest privately-owned enterprises, was reported as having raised RMB 5 billion (about US\$805m) via its crowdfunding platforms.¹⁰⁰ 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.

4. 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 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.

⁹⁶ Paul Bischoff, “Baidu now lets anyone invest in movies, will make Chinese version of *Gone with the Wind*”, TECHINASIA (22 September 2014), available at: <https://www.techinasia.com/baidu-lets-invest-movies-chinese-version-emgone-windem/>

⁹⁷ See above n 48, “China Financial Stability Report 2014”, at 174-175.

⁹⁸ The data information is collected from www.wangdaizhijia.com a Chinese website providing all sorts of information on P2P lending in China. For the P2P data, see <http://shuju.wangdaizhijia.com/industry-type-0-7-2015.html>. For a recent report on the development of P2P lending in China, see Mingkang Liu, “Internet Finance and Regulation in China”, FGI Report (August 2015), available at: <http://www.asiaglobalinstitute.hku.hk/en/internet-finance-regulation-china/>

⁹⁹ Tracey Xiang, “China’s Crowdfunding Market as of 2014”, TechNode (23 January 2015), available at: <http://technode.com/2015/01/23/chinas-crowdfunding-market-2014/>

¹⁰⁰ Esther Fung, “China’s Wanda Group Raises \$805 Million in Crowdfunding Push”, The Wall Street Journal (19 June 2015), available at: <http://www.wsj.com/articles/chinas-wanda-group-raises-805-million-in-crowdfunding-push-1434687631>

As shown in section 2, 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 11th Five-Year Plan.¹⁰¹ 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 12th 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.¹⁰² 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.¹⁰³ 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.¹⁰⁴ 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".¹⁰⁵ More recently in 2012 and 2013, the CBRC re-emphasized the significance of digital finance to the enhancement of financial inclusion and the development of China's financial sector.¹⁰⁶

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.¹⁰⁷ In a policy briefing held by the State Council in January 2015, the need for balanced regulation and supervision of digital finance was emphasised.¹⁰⁸ Two months later during the 3rd Session

¹⁰¹ See Zhou Xiaochuan, "Achievements of Financial Sector Reform and Development in the 11th Five-Year Plan Period", The People's Bank of China (9 December 2010), available at:

<http://www.pbc.gov.cn/publish/english/955/2011/20110217095304062355521/20110217095304062355521.html>

¹⁰² See The 12th Five-year Plan for the Development and Reform of the Financial Industry, at 38, available at: http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/201210/W020121010631355001488.pdf

¹⁰³ See generally above n 36, Tang, Zhang & He, "The Rise of Digital Finance in China", at 11-12; above n 47, Shrader & Duflos, "China: A New paradigm in Branchless Banking", at 21-27.

¹⁰⁴ See above n 48, "China Financial Stability Report 2014", at 172-173.

¹⁰⁵ See CBRC, *Guidelines on Financial Innovation of Commercial Banks*, promulgated on 6 December 2006 and effective on 11 December 2006, official translation available at: <http://www.cbrc.gov.cn/EngdocView.do?docID=2897>

¹⁰⁶ See above n 47, Shrader & Duflos, "China: A New paradigm in Branchless Banking", at 21, 23.

¹⁰⁷ See above n 48, "China Financial Stability Report 2014", at 178-179.

¹⁰⁸ See The State Council of the PRC, "Full transcript of policy briefing of the State Council on Jan 23, 2015", 23 January 2015, available at: http://english.gov.cn/news/policy_briefings/2015/01/23/content_281475043823916.htm

of the 12th 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”.¹⁰⁹ 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.¹¹⁰

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.¹¹¹ 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.¹¹² 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-

¹⁰⁹ See China Daily, “China to issue guidelines for Web finance companies”, 5 March 2015, available at: <http://www.ecns.cn/business/2015/03-05/156739.shtml>

¹¹⁰ See above n 48, “China Financial Stability Report 2014”, at 178-179.

¹¹¹ See generally above n 36, Tang, Zhang & He, “The Rise of Digital Finance in China”, at 12; above n 47, Shrader & Duflos, “China: A New paradigm in Branchless Banking”, at 22. Also see China Daily, “Self-regulation of online financial industry”, 4 April 2014, available at: http://china.org.cn/business/2014-04/04/content_32001588.htm

¹¹² Ibid.

regulation of the industry¹¹³ in line with the 5th principle set out in the PBOC Report 2014, rules developed by the financial regulators, and its own articles of association.

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.¹¹⁴ 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.”¹¹⁵

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.

4.1 CBRC Rules on Internet Banking

In 2006, the CBRC issued *Rules on the Administration of Electronic Banking* (CBRC E-banking Rule)¹¹⁶, and *Guidelines on E-banking Security Evaluation*¹¹⁷ (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*

¹¹³ See above n 111, “Self-regulation of online financial industry”. The official website of ACIFI is here: <http://www.acifi.org/index.asp> (in Chinese)

¹¹⁴ See, for example, above n 109, “China to issue guidelines for Web finance companies”; J. An, B. Zhao & W. Wang, “The Internet Finance in China: The Living Space and the Regulations” (2015)8(S4) *Indian Journal of Science and Technology* 106-114; BangKun An & Jinyang Ruan, “Hu Lian Wang Jin Rong: Jian Guan Yu Fa Lv Zhun Ze” (“Internet Finance: Regulation and Legal Principles”) (2014)3 *Jin Rong Jian Guan Yan Jiu (Financial Regulation Studies)* 57-70. (in Chinese – article and journal titles translated by the author); Li Youxing, Chen Fei & Jin Youfang, “Hu Lian Wang Jin Rong Jian Guan De Tan Xi” (A Study on the Regulation of the Internet Finance) (2014)44(4) *Journal of Zhejiang University* 87-97 (in Chinese – article title translated by the author).

¹¹⁵ See above n 48, “China Financial Stability Report 2014”, at 178.

¹¹⁶ *Dian Zi Yin Hang Ye Wu Guan Li Ban Fa (Rules on the Administration of Electronic Banking)*, promulgated by CBRC Decree No. 5 on 26 January 2006, effective on 1 March 2006. The Chinese official version of the Rule is here: http://www.cbrc.gov.cn/govView_EAB589F936AD446DA3F711CEE97F2D9.html and a translated version is available at: <http://www.lawinfochina.com/display.aspx?lib=law&id=4913&CGid>

¹¹⁷ *Dian Zi Yin Hang An Quan Ping Gu Zhi Yin (Guidelines on E-banking Security Evaluation)*, promulgated by CBRC Decree No. 9 on 26 January 2006, effective on 1 March 2006. The Chinese official version of the Rule is here: http://www.cbrc.gov.cn/chinese/home/docDOC_ReadView/2245.html and a translated version is available at: <http://www.lawinfochina.com/display.aspx?lib=law&id=5816&CGid=>

*Principles for Electronic Banking 2003*¹¹⁸) and the regulatory experience of developed countries (particularly the US and the EU).¹¹⁹

The objective of the CBRC E-banking Rule is 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 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 3 months in advance with the notification made

¹¹⁸ Basel Committee on Banking Supervision, *Risk Management Principles for Electronic Banking*, July 2003, available at: <http://www.bis.org/publ/bcbs98.pdf>

¹¹⁹ CBRC, Yin Jian Hui Fa Yan Ren Jiu Dian Zi Yin Hang Ye Wu Guan Li Ban Fa He Dian Zi Yin Hang An Quan Ping Gu Zhi Yin Da Ji Zhe Wen (CBRC Spokesperson Answers Questions of Reporters on *Rules on the Administration of Electronic Banking and Guidelines on E-banking Security Evaluation*), undated, available at: <http://www.cbrc.gov.cn/chinese/home/docView/2243.html> (in Chinese - title translated by the author)

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 have not 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.¹²⁰ 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 financial accountability and the sustainable development of e-banking businesses in China.

However, weaknesses of the two measures can also be identified.¹²¹ 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.

¹²⁰ See above n 50, Yuan, “Present and Future of Internet Banking in China”, at 5.

¹²¹ See, for example, Lanyu Wang, “Wo Guo Wang Shang Yin Hang Jian Guan De Bu Zu Ji Wan Shan Lu Jing” (The Weaknesses of China’s Regulation of Internet Banking and Some Recommendations), *Cai Kuai Yue Kan (Finance & Accounting Monthly)*, November 2011, 92-93, available at: http://pdf2012.cyk.cn/upload_files/20120331/7868769.pdf (in Chinese - article and journal titles translated by the author); Yong Pan & Yan Xing, “Lun Wo Guo Wang Shang Yin Hang De Jian Guan Ji Qi Wan Shan” (An Analysis of China’s Regulation of Internet Banking and Some Recommendations), *China Civil and Commercial Law* (28 December 2010), available at: <http://old.civillaw.com.cn/article/default.asp?id=51686> (in Chinese – article title translated by the author)

4.2 PBOC Rules on Third Party Payment Services

In 2010, the PBOC issued *Rules on the Administration of Payment Services Provided by Non-Financial Institutions*¹²² (PBOC Payment Rule) and *Measures on the Implementation of the Rules on the Administration of Payment Services Provided by Non-Financial Institutions*¹²³ (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. 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 is aimed 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

¹²² *Fei Jin Rong Ji Gou Zhi Fu Fu Wu Guan Li Ban Fa (Rules on the Administration of Payment Services Provided by Non-Financial Institutions)*, promulgated by PBOC Decree No. 2 on 14 June 2010, effective on 1 September 2010. The Chinese official version of the Rule is here: http://www.gov.cn/flfg/2010-06/21/content_1632796.htm and a translated version is available at: <http://www.lawinfochina.com/Display.aspx?lib=law&Cgid=134238>

¹²³ *Fei Jin Rong Ji Gou Zhi Fu Fu Wu Guan Li Ban Fa Shi Shi Xi Ze (Measures on the Implementation of the Rules on the Administration of Payment Services Provided by Non-Financial Institutions)*, promulgated by PBOC Decree No. 17 on 1 December 2010, effective on the same date. The Chinese official version of the Rule is here: http://www.gov.cn/gzdt/2010-12/03/content_1759169.htm and a translated version is available at: <http://www.lawinfochina.com/display.aspx?lib=law&id=8564&CGid>

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 publically 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.¹²⁴ However, the PBOC has clarified that the Rule is not intended to impose any quantitative restrictions and will allow

¹²⁴ Yingzhi Fang, *Fei Jin Rong Ji Gou Zhi Fu Fu Wu Guan Li Ban Fa Jie Du Bao Gao* (An evaluation report on *Rules on the Administration of Payment Services Provided by Non-Financial Institutions*), China E-Commerce Research Centre (CECRC) (26 June 2010), available at: <http://b2b.toocle.com/detail--5232440.html> (in Chinese - title translated by the author)

the issuance of a PSL to all qualified applicants.¹²⁵ According to the PBOC, there have been around 270 licensed payment institutions by May 2015.¹²⁶ 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 3rd Session of the 12th 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.¹²⁷ 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 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.

4.3 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

¹²⁵ Ren Min Yin Hang Jiu Fei Jin Rong Ji Gou Zhi Fu Fu Wu Guan Li Ban Fa Da Wen (PBOC Answers Questions of Reporters on *Rules on the Administration of Payment Services Provided by Non-Financial Institutions*), 28 June 2010, available at: <http://cfg.fabao.cn/falvfagui/sfwj/n214184927.shtml> (in Chinese - title translated by the author)

¹²⁶ PBOC, Yi Huo Xu Ke Ji Gou (Zhi Fu Ji Gou) (Licensed Payment Institutions), available at: <http://www.pbc.gov.cn/publish/zhengwugongkai/3580/index.html> (in Chinese - webpage title translated by the author)

¹²⁷ Yuzhe Zhang, Zhou Dong Xue Dai Biao: Ying Jin Kuai Chu Tai Fei Jin Rong Ji Gou Zhi Fu Fu Wu Guan Li Tiao Li (Representative Zhou Dongxue: *Regulations on Payment Services Provided by Non-Financial Institutions* should be promulgated), CAIXIN (4 March 2015), available at: <http://topics.caixin.com/2015-03-04/100787732.html> (in Chinese - title translated by the author)

promulgation of regulations on P2P lending.¹²⁸ In response, the CBRC issued *Circular on Risks Associated with Peer-to-Peer Lending* (CBRC P2P Circular) on 23 August 2011.¹²⁹ 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 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 2014.¹³⁰ These risks may also arise from crowdfunding activities.¹³¹

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 lending and crowdfunding and is currently consulting with other authorities, relevant industries, experts and other stakeholders.¹³² 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).¹³³ 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

¹²⁸ Takeshi Jungu, “Risks and Opportunities in China’s Growing P2P Lending Market”, Nomura Research Institute (10 September 2014), at 2, available at: <https://www.nri.com/~media/PDF/global/opinion/lakyara/2014/lkr2014202.pdf>; Jinyan Zhang, “Lun Wo Guo Ren Ren Dai De Fa Zhan Xian Zhuang, Zhu Yao Feng Xian Ji Fa Lv Gui Fan” (An Analysis of the Current State, Major Risks and Regulations of P2P Lending in China) (2013)(3) *Xi Nan Jin Rong (Southwest Finance)*, available at: <http://202.119.108.161:93/modules/showContent.aspx?title=&Word=&DocGUID=fa477088bf1a45139fa721de20468e8d> (in Chinese – article and journal title translated by the author)

¹²⁹ *Guan Yu Ren Ren Dai You Guan Feng Xian Ti Shi De Tong Zhi (Circular on Risks Associated with Peer-to-Peer Lending)*, promulgated by the General Office of the CBRC Circular No. 254 on 23 August 2011, effective on the same date. The Chinese official version of the Rule is here: http://www.pkulaw.cn/fulltext_form.aspx?Db=chl&Gid=159009 and a translated version is available at: <http://en.pkulaw.cn/display.aspx?cgid=159009&lib=law>

¹³⁰ See above n 98, Liu, “Internet Finance and Regulation in China”, at 15.

¹³¹ Jerin Mathew, “China Warns of Illegal P2P Lending and Crowd Funding Loopholes”, International Business Times (22 April 2015), available at: <http://www.ibtimes.co.uk/china-warns-illegal-p2p-lending-crowd-funding-loopholes-1445535>

¹³² See, for example, JD Alois, “China Banking Regulatory Commission is Circulating Peer to Peer Lending Rules”, Crowdfund Insider (19 March 2015), available at: <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 (2 February 2015), available at: <http://www.crowdfundinsider.com/2015/02/62055-china-draft-regulations-published-for-equity-crowdfunding-as-sharein-partners-with-bop-to-expand/>

¹³³ A Chinese version of the consultation draft can be found here: <http://www.sac.net.cn/tzgg/201412/P020141218543931814762.doc>. No translated version has been made available.

forms of crowdfunding activities which have represented the majority of crowdfunding platforms in China.¹³⁴

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*¹³⁵ 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*¹³⁶ 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*¹³⁷ 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 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.

4.4 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

¹³⁴ See Tracey Xiang, "China's Crowdfunding Market as of 2014", TechNode (23 January 2015), available at: <http://technode.com/2015/01/23/chinas-crowdfunding-market-2014/>

¹³⁵ *Contract Law of the PRC*, adopted at the 2nd meeting of the 9th NPC on 15 March 1999, effective on 1 October 1999.

¹³⁶ *General Rules on Loans*, promulgated by PBOC Decree No. 2 on 28 June 1996 and effective on 1 August 1996.

¹³⁷ *Criminal Law of the PRC*, adopted at the 2nd meeting of the 5th NPC on 1 July 1979; amended on 14 March 1997, 25 December 1999, 31 August 2001, 28 December 2002, 28 February 2005, 29 June 2006, 28 February 2009, and 25 February 2011.

crack down on these platforms.¹³⁸ In the absence of specific rules, the existing legislation mentioned above provides some basic rules applicable to these activities.

4.5 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' 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 *Law of the PRC on Protection of Consumer Rights and Interests*¹³⁹ and *Anti-Unfair Competition Law of the PRC*¹⁴⁰.

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.¹⁴¹ 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 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.¹⁴² 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

¹³⁸ See, for example, Paul Mozur, "Baidu CEO Calls for More Regulation of Online Funds", The Wall Street Journal (3 March 2014), available at: <http://www.wsj.com/articles/SB10001424052702304585004579418141247893328>.

¹³⁹ *Law of the PRC on Protection of Consumer Rights and Interests*, adopted at the 4th Meeting of the Standing Committee of the 8th NPC on 31 October 1993; amended on 27 August 2009, and 25 October 2013 and effective as of 15 March 2014.

¹⁴⁰ *Anti-Unfair Competition Law of the PRC*, adopted at the 3rd session of the Standing Committee of the 8th NPC, promulgated on 2 September 1993, effective on 1 December 1993.

¹⁴¹ 2015 Hu Lian Wang Jin Rong Xiao Fei Zhe Quan Yi Bao Hu Lun Tan (2015 Forum on the Protection of Consumers in Digital Finance Sector), held on 14 March 2015 in Renmin University, Beijing, information page available at: <http://www.xinhuanet.com/live/20150314a/index.htm> (in Chinese - title translated by the author)

¹⁴² ACIFI, "2015-2018 Nian Hu Lian Wang Jin Rong Fa Zhan Zhi Dao Gang Yao" (Guidelines on the Development of China's Digital Finance Sector 2015-2018), published on 5 June 2015, available at: <http://www.a-cifi.org/hyzlview.asp?id=998> (in Chinese – title translated by the author)

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.

4.6 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.¹⁴³

China has been very active in establishing an AML regime.¹⁴⁴ In 2006, China published its first general AML statute, the *Law of the PRC on Anti-Money Laundering*¹⁴⁵ (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*¹⁴⁶ 2006 (PBOC AML Rule), *Measures on the Administration of Reporting of Large-Value and Suspicious Transactions by Financial Institutions*¹⁴⁷ 2006 (PBOC Reporting Measure), *Circular on Further Strengthening the Anti-Money Laundering Work of Financial Institutions*¹⁴⁸ 2008 (PBOC AML Circular), and *Measures on the Administration of Anti-Money Laundering and Anti-Terrorist Financing of Payment Institutions*¹⁴⁹ 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

¹⁴³ Louise Malady, Ross Buckley & Douglas Arner, “Developing and Implementing AML/CFT Measures using a Risk-Based Approach for New Payments Products and Services”, research funded by CIFR, UNCDF, Standard Chartered Bank and UNSW, 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; Lixin Yan, Lishan Ai & Jun Tang, “Risk-based AML regulation on internet payment services in China” (2011)14(1) *Journal of Money Laundering Control* 93-101.

¹⁴⁴ For a comprehensive study on China’s AML regime in the financial industry and analysis of the weaknesses of the regime, see Lishan Ai, *Anti-money Laundering (AML) Regulation and Implementation in Chinese Financial Sectors: Money-Laundering Vulnerabilities and the ‘Rule-Based but Risk-Oriented’ AML Approach*, PhD Thesis submitted to the University of Wollongong 2012, available at: <http://ro.uow.edu.au/cgi/viewcontent.cgi?article=4643&context=theses>; Nicole Schulte-Kulkmann, “How China Fights Money Laundering: Recent Developments in Regulation and Supervision”, Research Group on the Political Economy of China, Trier University, China Analysis No. 56 (February 2007), available at: http://www.chinapolitik.de/studien/china_analysis/no_56.pdf.

¹⁴⁵ *Law of the PRC on Anti-Money Laundering*, adopted at the 24th Meeting of the Standing Committee of the 10th NPC on 31 October 2006, effective on 1 July 2007. Official translation available at: http://www.china.org.cn/china/LegislationsForm2001-2010/2011-02/11/content_21900160.htm

¹⁴⁶ *Rules for Anti-Money Laundering by Financial Institutions*, promulgated by the PBOC Decree No. 1 on 6 November 2006, effective on 1 January 2007. Official translation available at: http://english.gov.cn/services/investment/2014/08/23/content_281474982978019.htm

¹⁴⁷ *Measures on the Administration of Reporting of Large-Value and Suspicious Transactions by Financial Institutions*, promulgated by the PBOC Decree No. 2 on 14 November 2006, effective on 1 March 2007. Official Chinese version is here: <http://www.msffunds.com.cn/upload/201505/08/201505080930439888.pdf>; a translated version is available at: <http://www.lawinfochina.com/display.aspx?lib=law&id=5645&CGid=>

¹⁴⁸ *Circular on Further Strengthening the Anti-Money Laundering Work of Financial Institutions*, promulgated by the PBOC Circular No. 391 on 30 December 2008. Official Chinese version is here: <https://www.lionfund.com.cn/data/20090610154950fanxq.pdf>; a translated version is available at: <http://www.lawinfochina.com/display.aspx?lib=law&id=7303&CGid=>

¹⁴⁹ *Rules on the Administration of Anti-Money Laundering and Anti-Terrorist Financing of Payment Institutions*, promulgated by the PBOC Decree No. 54 on 5 March 2012. Official Chinese version is here: http://www.pbc.gov.cn/publish/fanxiqianju/696/2012/20120412161459545740867/20120412161459545740867_.html

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.¹⁵⁰

The AML Law is based on three overarching objectives including, protection of financial integrity, anti-corruption and harmonisation with international standards.¹⁵¹ 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 (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.¹⁵²

¹⁵⁰ The project is run by Professor Sebastian Heilmann and Nicole Schulte-Kulkmann – the quote is extracted from the project description here: <http://www.chinapolitik.de/regem/aml/index.html>.

¹⁵¹ See above n 144, Kulkmann, “How China Fights Money Laundering: Recent Developments in Regulation and Supervision”, at 7-8; Ai, *Anti-money Laundering (AML) Regulation and Implementation in Chinese Financial Sectors*, at 67-70.

¹⁵² See above n 144, Kulkmann, “How China Fights Money Laundering: Recent Developments in Regulation and Supervision”, at 11-12; Ai, *Anti-money Laundering (AML) Regulation and Implementation in Chinese Financial Sectors*, at 68.

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).¹⁵³ 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.¹⁵⁴

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.¹⁵⁵ 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 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.¹⁵⁶ 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

¹⁵³ See above n 143, Yan, Ai & Tang, “Risk-based AML regulation on internet payment services in China”, at 97.

¹⁵⁴ See above n 143.

¹⁵⁵ See above n 144, Kulkmann, “How China Fights Money Laundering: Recent Developments in Regulation and Supervision”, at 12-13.

¹⁵⁶ See above n 144, Ai, *Anti-money Laundering (AML) Regulation and Implementation in Chinese Financial Sectors*, at 92-93.

standards.¹⁵⁷ 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.¹⁵⁸ 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.¹⁵⁹ 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.¹⁶⁰ 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.¹⁶¹ 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.¹⁶²

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.

¹⁵⁷ Ibid., at 140-143.

¹⁵⁸ Ibid., at 192-200.

¹⁵⁹ Ibid., at 228-262.

¹⁶⁰ See above n 143, Yan, Ai & Tang, "Risk-based AML regulation on internet payment services in China"; above n 144, Ai, *Anti-money Laundering (AML) Regulation and Implementation in Chinese Financial Sectors*, at 264-301.

¹⁶¹ See above n 144, Ai, *Anti-money Laundering (AML) Regulation and Implementation in Chinese Financial Sectors*, at 135.

¹⁶² See, for example, above n 144, Kulkmann, "How China Fights Money Laundering: Recent Developments in Regulation and Supervision".

5. 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.¹⁶³ 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 POBC 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:

¹⁶³ See above n 98, Liu, "Internet Finance and Regulation in China", at 28.

- (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 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 welcome. 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*¹⁶⁴ issued by the PBOC on 31 July 2015 and the consultation draft *Regulation on Non-Depositing Loan Institutions*¹⁶⁵ issued by the State Council on 12 August 2015. With this momentum, a comprehensive regulatory framework for DFS by the end of the year would not surprise.

6. 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 markets¹⁶⁶ and among the most active of regulators of digital finance in a short period of time. Thanks to the supportive

¹⁶⁴ *Fei Yin Hang Zhi Fu Ji Gou Wang Luo Zhi Fu Ye Wu Guan Li Ban Fa (Zheng Qiu Yi Jian Gao)*, official Chinese version available at: http://www.gov.cn/xinwen/2015-07/31/content_2907209.htm

¹⁶⁵ *Fei Cun Kuan Lei Fang Dai Zu Zhi Tiao Li (Zheng Qiu Yi Jian Gao)*, official Chinese version available at: <http://www.chinalaw.gov.cn/article/cazjgg/201508/20150800478726.shtml>

¹⁶⁶ See, for example, Shai Oster, "A Hundred Apps Bloom in China as Millions Bank on Their Phones", BloombergBusiness (20 August 2015), available at: <http://www.bloomberg.com/news/articles/2015-08-19/wechat-baidu-and-alibaba-help-chinese-embrace-digital-banking>

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