

The rise of online finance in China and the legal grey area

Online financial activities such as peer-to-peer lending and online third-party payments have been growing in popularity in China since the 1990s. But the rise of such services has led to fresh challenges for China's regulatory authorities. Kevin Wang, a Partner at CMS in China, explores how online financial services are developing in the country, the legal grey areas and the current regulatory stance.

The past few years have witnessed the remarkable development of online finance in China. New forms of financial services provided through the internet have posed great challenges for the traditional financial players.

Popular online financial activities in China

Online third-party payments

Along with the development of online purchasing behaviours in Chinese society, online third-party payment systems have undergone a tremendous growth period with huge increases. Nowadays, online third-party payment services are offered not only for transfer of purchase price for online purchase but also for payment of public utility fees and traffic fines as well as repayment of credit cards. Due to the development of online third-party payment systems, the traditional bank remittance service is to a certain extent adversely affected.

In China, in order to provide online third-party payment services, any non-financial companies must apply to the People's Bank of China (the 'PBOC') for a so-called 'Payment Business Licence.' On 10 July 2013, the PBOC issued its seventh batch of Payment Business Licences to 27

companies. Among these 27 companies, it is noteworthy that there are also two foreign invested companies, i.e. Edenred and Sodexo. This is the first time that such licences have been issued to foreign invested companies. Up until now, there are already around 250 companies that have obtained Payment Business Licences.

Since the launch of the first online third-party payment tool in China in 1999, for more than a decade, the development of online third-party payments have been in a grey area lacking supervision. Until the 21 June 2010, when the PBOC issued the 'Measures for the Administration of Payment Services of Non-Financial Institutions,' which stipulated the supervision authority and application procedures for the licensing of online payment activities.

P2P lending

The liquidity crisis has caused the tightening of lending criteria by the banks, which has forced small borrowers to turn to alternate avenues for credit. Originating in the UK, online peer-to-peer (P2P) lending services originally refer to the provision of an online platform that enables lenders and borrowers to deal directly with each other, without the need for a middle-man.

Online P2P lending services have quickly developed in China; according to some unofficial statistics, currently the number of P2P companies exceeds 2000, among which several companies have achieved an annual financing volume of RMB 100 million. However, unlike the scenario in the UK, online P2P lending services have evolved with new features in China. For instance, several P2P companies also conduct such activities as the assignment of credit rights, provision of

guarantee and cooperation with the loan companies.

On 23 August 2011, the China Banking Regulatory Commission ('the CBRC') issued the 'Notice on Risk Alert of P2P Service,' which disclosed the risks existing in the online P2P lending service including the credit risk of the borrower, the risk of illegal fund-raising and the risk of money laundering.

The above-mentioned legal risks might occur due to the following reasons:

(1) No clear supervision authority. In several areas including Wenzhou, Zhejiang Province, the supervision work has been carried out by the local Financial Service Office, the legitimacy of which has been questioned.

(2) No clear market access threshold. For the time being, the establishment procedures of an online P2P lending company are the same as those for an ordinary company except that it has to file a recordal of its website with the competent telecoms authority. In other words, no additional qualifications or licensing requirements have to be met in spite of the financial services features of online P2P lending companies, and despite the fact that the wider financial services industry in China is heavily regulated.

(3) Lack of legislation. The lack of governing laws, regulations and industrial guidance has left room for online P2P lending companies' business operations that may cause a threat to financial safety.

Online sale of open-ended funds

In June 2013, Alibaba Group promoted an innovative online financial product called 'Yu'E Bao,' according to which the users of Alipay (similar to PayPal) may transfer the balance of their Alipay accounts to their Yu'E Bao

accounts and any amount in the Yu'E Bao account will be automatically used to buy the monetary open-ended fund of a small fund company in China, i.e. Tianhong Asset Management Co., Ltd.

The Yu'E Bao product became an instant hit shortly after its launch; however, only eight days later, the China Security Regulatory Commission ('the CSRC') claimed that the launch of Yu'E Bao was not in full compliance with the regulations of open-ended fund sales in China and ordered Alibaba Group and Tianhong to submit the relevant documents for record-filing in accordance with the 'Interim Provisions on Administration of Settlement Capital from the Sales of Securities Investment Fund.' Both Alibaba Group and Tianhong responded that they would meet regulatory requirements as soon as possible. Currently, the Yu'E Bao product continues to be offered and has enjoyed a rapid growth in its number of users and the amount of funds for purchasing the monetary fund through Yu'E Bao. According to the data provided by Alibaba Group, 18 days after the promotion of the Yu'E Bao product, the accumulated amount transferred to Yu'E Bao for buying the monetary fund of Tianhong exceeds RMB 6.6 billion.

Nowadays quite a large number of funds companies are in a hurry to open their stores on Taobao (similar to eBay) to sell their products. However, the schedule for such stores has been delayed several times due to regulatory reasons. According to the 'Interim Provisions on the Administration of the Business Operations of Securities Investment Fund Distributors through Third-Party E-Commerce Platforms,' issued on 15 March 2013, where a third-party e-commerce platform

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conducts the fund sales business independently, the platform operator shall obtain the qualification for engaging in the fund sales business. Taobao might still be in the process of obtaining such a qualification application. Both the fund companies and the consumers are optimistic about such fund stores on Taobao, which are deemed to greatly facilitate purchase procedures and are expected to enjoy great popularity.

Regulatory authority stance and the future

Online financial services in China are still in their nascent stage. The existing legislations have not been developed in time to reflect all the new changes in this market.

The Chinese regulatory authorities are taking an active attitude towards the development of online finance. On 1 August 2013, a so-called Online Finance Development and Supervision Research Team composed of officials from seven ministries went to Shanghai and Hangzhou to conduct a local survey. The PBOC has given a high appraisal to online finance in its recently issued 'Implementation Report of the Monetary Policy of the Second Quarter.' It deems that, as an emerging industry which combines traditional financial services and the internet, online finance is highly transparent, widely participated in and has low intermediary costs, convenient payment solutions, an affluent credit database and a higher efficiency of information handling. Meanwhile, as a new financial model, online finance puts forward higher requirements on financial supervision, financial consumer protection and macroeconomic control. In the next step, it is expected that relevant new regulations will be drafted and promulgated to lead the online

financial industry to grow in a healthy way.

Online financial services might threaten the dominant position of the traditional financial service players in the market in the future, especially the banks, which are at risk of becoming less innovative due to the increasing regulatory obligations and mounting costs.

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Nevertheless, the banks have become aware of the necessity of developing their online banking services in order to keep their market shares, e.g. online lending platforms, payment via internet or mobile phone and the provision of banking services through WeChat (a mobile text and voice messaging communication service). On the other hand, the banks have started to cooperate with internet companies. It is reported that China Minsheng Bank is collaborating with Alibaba Group to provide financial services, such as offering wealth management products, credit card operations, and electronic banking.

We expect to see more and more collaborations between traditional financial institutions and internet companies. More and more people in China believe that it is a given that most of the banking activities will be conducted online and one or two internet companies will become the leading players in the finance industry in China in the next 10 years.

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