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Introduction

1.1 Overview

With the rapid expansion of the internet market and the booming of start-ups and small and medium-sized enterprises (SMEs), China has, over the past decade, seen explosive growth of so-called internet finance, a joint product of internet and the financial sector, which is more commonly referred to as Fintech in other jurisdictions. The term 'Fintech', a portmanteau word made of 'finance' and 'technology', is often used to describe the intersection of finance and technology. As the technology is mainly related to the internet, it has come to be known as internet finance in China. In fact, there is no precise and widely accepted definition of internet finance or Fintech. While Fintech is basically understood as technologies which are used to change and improve the existing business mode of finance,[1] internet finance is defined as 'a new type of financial mode that integrates the functions of financing, payment and information media via internet and mobile communications technology'.[2]

Although the two terms may have some subtle difference in terms of their focus, they essentially cover the same subject matter and thus will be used interchangeably in this chapter. For instance, as the Hong Kong Steering Group on Financial Technologies (Steering Group) suggested, Fintech 'may refer to the application of information and communication technology in the field of financial services',[3] mainly including digital payment and remittance, financial product investment and distribution platforms, peer-to-peer (P2P) financing platforms, cybersecurity and data security technology, big data and data analytics, as well as distributed ledgers.[4]

[1] Daniel McAuley, 'What Is FinTech', 23 October 2015, https://medium.com/wharton-fintech/what-is-fintech-77d3d5a3e677#.k5c6aipyy.
[2] Financial Stability Analysis Group of the People's Bank of China, *China Financial Stability Report 2014* (China Financial Publishing House, July 2014), p 171.
[3] Steering Group, *The Report of the Steering Group on Financial Technologies*, 26 February 2016, p 13, www.fstb.gov.hk/fsb/ppr/report/doc/Fintech_Report_for%20publication_e.pdf.
[4] Ibid, pp 15–16.

At the international level, major advancements in Fintech in the past few years have created a race among nations to be the next big Fintech hub. One of the main enablers of success in the development of a successful Fintech ecosystem is regulations. Laws and regulations set the direction for Fintech development. If such regulations are too stringent, they may dissuade start-ups, whose lean business models cannot afford to comply with the costly regulations in the traditional manner. But one should not throw caution to the wind, because Fintech is still subject to issues of fraud or loss of investment, and extremely relaxed regulations can put participants in Fintech at risk. Hence, there is a great need to strike a proper balance between fostering innovation and protecting consumers.

1.2 China's Fintech Markets and Regulatory Responses

As noted above, despite the widespread use of the term, Fintech does not have a settled definition. One reason is that the Fintech market is in a constant state of flux, with the rapid emergence of new products and the ongoing evolution of technologies. Furthermore, the Fintech industry appears to vary from country to country because, as a disruptive form of financial innovation, Fintech is closely related to and deeply shaped by the local financial system. Indeed, it is neither desirable nor feasible to come up with a universal and static definition of Fintech. Hence, instead of covering a little bit of everything that might be broadly seen as Fintech, this book will focus on several representative sectors of Fintech in the specific context of China.

1.2.1 Online P2P Lending

As noted earlier, the P2P financing platform is a key Fintech player, which refers to an online platform that matches capital providers and capital users, where the operator of the platform manages and facilitates the financing process. When the financing mode takes the form of a loan, it is usually known as online P2P lending, also called online or P2P lending.

As an important form of the Fintech industry, China's online P2P lending has undergone a roller-coaster period in the past decade.[5] There was an explosive growth in the first several years to become the largest in the world, with online lending platforms having mushroomed across the

[5] This topic will be discussed in more detail in Chapter 2.

country. Then, it was followed by a free fall in the past couple of years and hence the market shrank drastically, with the closure or transformation of most of the platforms. There are good reasons behind each of the two phases. The initial rapid development is a consequence of the simultaneous emergence of three key factors, namely deep penetration of the internet, large supply of funds and unmet financial needs. The early market exhibited several distinctive features in terms of the size of platforms, the level of market concentration and business models. As online lending gathers momentum in China, many problems have come to light. In 2016, China issued an important regulation for online lending, introducing a number of significant measures, such as the restriction on the business model that can be adopted by platforms, registration requirements, custodian requirements, information disclosure requirements and lending limits. The regulation has far-reaching implications, including a reshuffling of the market and more collaboration between online lending platforms and traditional banks. However, now it appears that the regulation has failed to achieve its purposes due to the problems with both substantive rules and enforcement mechanisms.

1.2.2 Offering and Trading of Cryptoassets

Cryptoassets, or virtual assets, which is another name some would call it, have emerged as a very hot topic of Fintech in recent years, attracting a great deal of attention from market participants and regulators. Bitcoin is probably the most well-known cryptoasset and has frequently popped up in the headlines of newspapers over the years. The number of cryptocurrencies has grown substantially since January 2009 when Bitcoin was created, and other popular cryptoassets include Ethereum, DASH and Ripple, to name but a few. Nowadays even traditional investors would no longer ignore the impact of such cryptoassets. As cryptoassets are still in their early stage of development as compared to other more traditional and regulated trading markets, there are ongoing debates on their nature, usages and risks. It thus becomes very important to find a proper way to regulate cryptoassets, and the regulation of cryptoassets has two distinct but related aspects: one is about its offerings, namely initial coin offerings (ICO) and the other about its trading or use as a medium of exchange and value storing.

The ICOs, or 'token sales', refer to a new fundraising tool which allows organizations, mainly entrepreneurs or start-ups, to launch a business based on distributed ledger or blockchain technology to raise operating funds. The development trajectory of the ICOs in China is broadly similar to that of online P2P lending, or more accurately, the former presages the latter. Specifically, the ICOs underwent a period of explosive growth in China since the second half of 2016 but were then banned in September 2017. The outright ban on ICOs may hamper revolutionary technological developments and dampen the growth of this potentially beneficial market in China. Hence, by completely stifling technology innovation and market development, the Chinese regulatory approach needs to be reconsidered in light of international experiences. Indeed, ICOs can be broadly divided into five categories, namely pre-sales of products or services, offering of shares, issuing of debentures, issuing of derivatives, collective investment schemes and crowdfunding. Instead of a blanket ban, China should adopt a flexible and targeted regulatory approach according to the particular category of the ICOs.[6]

As a result of the broad ban on ICOs, cryptoassets cannot be created nor traded in China. Furthermore, as some scholars have insightfully pointed out, statutory intervention is required for the commodification of cryptoassets, particularly in civil law jurisdictions.[7] This is certainly true for China. As there is not much to be discussed about the Chinese law on cryptoassets, this book will instead look at the relevant law in Hong Kong, which is a special administration region in China and has considerable influence on Mainland China in relation to the financial markets and the relevant regulation. Due to the difficulties in regulating cryptoassets under the traditional framework, Hong Kong has set up its first comprehensive regulatory regime on cryptoassets in November 2018, imposing new standards on cryptoasset fund managers, distributors and platform operators. In November 2019, Hong Kong further clarified its position on the regulation of cryptoasset exchanges. Indeed, while the characteristics of cryptoassets, such as anonymity and disintermediation in transactions, bring significant benefits, they come with a range of significant risks concerning investor protection and market integrity. Overall, the new regulatory regime for cryptoassets in Hong Kong is a significant development, addressing the issues of regulatory gaps and regulatory arbitrage that existed under the previous framework as well as introducing enhanced regulatory standards. This has the effect of improving investor protection, but there are some remaining concerns. Chief amongst them are the

6 This topic will be discussed in more detail in Chapter 3.
7 See e.g. Rainer Kulms, 'Blockchains: Private Law Matters' (2020) *Singapore Journal of Legal Studies* 63.

problems with regulatory scope, the application of traditional regulatory standards to cryptoassets that do not fall within the definition of securities or futures, problems with the sandbox mechanism, and ultimately as a matter of regulatory philosophy, the need for a better balance between investor protection and market development.[8]

1.2.3 Mobile Payment and Data Protection

China has become one of the leaders in the global mobile payment market in terms of market volume, growth rate and innovation capability. This can be attributed to a number of enabling factors, including technological advancement in China, mobile payment's competitive advantages and its wide acceptance by Chinese people. Mobile payment brings about significant benefits as well as various risks, and thus should be regulated in a way that reaps its benefits while containing the risks as well. Over the past decade, China has gradually established a regulatory regime which is composed of various rules issued by different regulators in a piecemeal manner. China's regulatory regime for mobile payment has several key elements, such as the entry and exit mechanism, management of customer reserves, anti–money laundering measures and consumer protection. The Chinese regulation has strengths and shortcomings, particularly in relation to the overall structure and approach of the regulation. There is also a need to address the negative effects on competition in the mobile payment market that may be brought about by the high entry threshold and the centralized clearing mechanism.[9]

While mobile payment brings great benefits such as convenience, flexibility and efficiency, they are not without risks. Among the risks that consumers face, the data privacy risk is probably one of the most serious, which is in large part caused and exacerbated by the involvement of multiple players and the extensive collection of personal information.[10] China has been trying to consolidate and modernize its regulatory regime for data privacy to suit the need of the new digital era. Over the past few years, China has made great efforts to enact new laws and regulations to delineate the scope of personal information, introduce obligations for data controllers and processors, and incorporate the principles of the Fair Information Practices. However, there are some

8 This topic will be discussed in more detail in Chapter 4.
9 This topic will be discussed in more detail in Chapter 5.
10 This topic will be discussed in more detail in Chapter 6.

remaining concerns, including, among others, the ineffective requirements of consent and disclosure, the ambiguous principle of purpose limitation, and the limited applicability of the principle of data minimization. There is a need for China to enact a specific law for data protection, establish a unified law enforcement agency, and enhance private and public enforcement. To be sure, the issue of data privacy is not unique or limited to mobile payment, and this area of discussion may apply to other sectors of Fintech and even beyond.

1.2.4 Robo-Advisor

As a form of artificial intelligence in the financial markets, robo-advisory has grown rapidly to provide automated investment services alongside human advisors. Automated investment advice firms have brought significant benefits by improving the delivery of high-quality and less-biased financial advice. However, robo-advisors also bring risks due to their high dependence on technology. To boost market development, the Chinese government has taken the development of intelligent finance as one of its key tasks. In the area of robo-advisory services, China has several advantages, such as strong consumer demand and a rapidly rising middle class, as well as disadvantages such as regulatory risks and low-level service quality. The overhigh and inconsistent entry threshold, insufficient asset management powers of robo-advisors, weak fiduciary duties and inadequate information disclosure duties have hindered the development of robo-advisory services in China.

Major Fintech jurisdictions such as the United States and Hong Kong have established sophisticated regulatory systems for robo-advisors in crucial aspects such as information disclosure and fiduciary duties. By analysing overseas experiences and local conditions, this research argues that Chinese law should allow robo-advisors to provide limited discretionary asset management services as well as consulting services. It recommends establishing a uniform piece of legislation for both human and artificial intelligence (AI) investment advisors, which contains consistent standards as well as additional requirements for robo-advisors. A streamlined and relaxed regulatory system for the entry threshold of the advisory service market should be established to regulate financial and non-financial companies. The robo-advisors should be subject to more detailed rules on information disclosure duties and fiduciary duties. The service provider and the algorism designer should be jointly and severally liable according to their roles in the investment decision-making processes.

1.2.5 Other Sectors

Equity crowdfunding was once a popular idea in China and almost gained formal recognition of the regulator. However, due to various reasons, particularly the later crisis of its sibling, namely debt crowdfunding or online P2P lending, equity crowdfunding failed to be written into the 2019 Securities Law. This means that in the foreseeable future, equity crowdfunding is unlikely to be legally permitted as a special Fintech sector in China. The situation may change, however, as the Chinese economy is facing increasingly serious downward pressure, and also because there are unique advantages to equity crowdfunding, particularly when it comes to the financing needs of small and medium-sized enterprises.

A very recent major development of Fintech in China is the Digital Currency Electronic Payment project (DC/EP) initiated by the People's Bank of China (PBOC), which is the Chinese central bank. Unlike Bitcoin and other types of cryptoassets, DC/EP has the backing of the credit of a state and is based on a more complicated system of operation. China is at the international forefront of developing central bank digital currency (sovereign digital currency), which has attracted a lot of attention. However, the development is still at its early stage and only time will tell as to how the DC/EP will operate in practice and what effects it will bring to the people in China and beyond.

1.3 Regulatory Framework

As discussed earlier, there is no clear definition of Fintech, and there are a growing number of businesses which could potentially be included under the rubric of Fintech. Indeed, apart from the general feature that they are enabled by the use of new technologies, these businesses are in fact so different from each other, in terms of the nature and type of business or the technologies applied. For instance, online P2P is considered a banking business while equity crowdfunding is one type of securities activity; mobile payment is a banking business while robo-advisor is a service of securities business. Hence, it may be more appropriate to treat Fintech as a new format of business rather than a new industry.

1.3.1 Governmental Regulators

As Fintech is not an industry, there is no unified law for the Fintech market as a whole, nor is there a unified industry regulator. This is particularly so in China, which adopts the traditional sectors-based regulatory structure for its financial markets.[11] As the central bank, the PBOC assumes responsibility for monetary policies and the stability of the financial system generally. The China Banking and Insurance Regulatory Commission (CBIRC) and the China Securities Regulatory Commission (CSRC) are the authorities responsible for regulating the banking and insurance sectors and the securities sector, respectively. Before April 2018, the banking and insurance sectors were regulated separately by the China Banking Regulatory Commission (CBRC) and the China Insurance Regulatory Commission (CIRC). The CBRC and the CIRC merged to form the CBIRC in April 2018.[12] For convenience, however, this book still refers to the CBRC as the banking regulator as many relevant rules on Fintech were actually issued by it, unless there is a special need to distinguish between the CBRC and the CBIRC.

On 14 July 2015, the PBOC led a total of ten governmental agencies and ministries to jointly issue 'Guiding Opinions on Promoting the Healthy Development of Internet Finance' (Guiding Opinions),[13] setting out the policy goals and division of regulatory responsibilities for the Fintech businesses in China. The Guiding Opinions consist of three parts. The first part indicates the overall policy of the Chinese government to encourage innovations and support the development of internet finance. In particular, it notes that internet finance can usefully supplement existing financial institutions and play an important role in promoting the growth of SMEs and creating jobs.

[11] Robin Hui Huang, *Securities and Capital Markets Law in China* (Oxford University Press, 2014), section 2.2. For a broader discussion of the institutional structure of financial regulation, see Robin Hui Huang and Dirk Schoenmaker (eds), *Institutional Structure of Financial Regulation: Fundamental Theories and International Experiences* (Routledge, 2015).

[12] For a detailed discussion of the reform and its implications, see Robin Hui Huang, 'zhongguo Jinrong Jianguan Tizhi Gaige de Luoji yu Luojing: Guoji Jingyan yu Bentu Xuanze'(中国金融监管体制改革的逻辑与路径：国际经验与本土选择) ['The Logics and Path of the Reform of China's Financial Regulatory Structure: International Experiences and Local Choice'] (2019) 3 *Faxue Jia* 法学家*[Jurist]* 124–137.

[13] Guanyu Cujin Wulianwang Jinrong Jiankang Fazhan de Zhidao Yijian 关于促进互联网金融健康发展的指导意见[Guiding Opinions on Promoting the Healthy Development of Internet Finance] (issued on 17 July 2015 by ten governmental agencies and ministries).

The second part attempts to divide regulatory responsibilities for internet finance amongst relevant regulators. In doing so, it sets out a guiding principle of 'regulation according to law, moderate regulation, sectoral regulation, collaborative regulation, and innovative regulation'. Internet finance is divided into six sectors, namely online payment, online lending (which includes P2P and internet-based small-loan business, equity crowdfunding), online sale of investment funds, online insurance and online trust and consumer finance. As China's central bank, the PBOC has the responsibility for online payment;[14] the CBRC (now CBIRC) for online lending as well as online trust and consumer finance;[15] the CIRC (now CBIRC) for online insurance;[16] and the CSRC for equity crowdfunding and online sale of investment funds.[17]

The third part of the Guiding Opinions outlines eight regulatory propositions for the internet finance markets, serving as a basis for more detailed regulatory rules to be issued by relevant regulators in the future. This includes mandatory disclosures; disclaimers and warnings by internet finance firms about their models and the risks involved; compliance with anti–money laundering laws; online security and privacy; consumer protection rules; and the requirement that all internet finance platforms should entrust commercial banks with the management of their clients' capital.

1.3.2 *Self-Regulatory Organization*

Apart from governmental agencies, there exist a variety of self-regulatory organizations, which are subject to regulatory oversight by the relevant governmental regulatory agencies, and which have varying levels of responsibility for their respective markets and the conduct of their members. Each traditional industry in the financial market has its self-regulatory organization, such as the China Banking Association, the Insurance Association of China, and the Securities Association of China.

On 25 March 2016, the National Internet Finance Association of China (NIFAC) was established as a national self-regulatory organization in the field of internet finance in China.[18] The NIFAC has ten self-regulatory responsibilities, including[19]

14 Ibid, art. 7.
15 Ibid, art. 8, 12.
16 Ibid, art. 11.
17 Ibid, art. 9, 10.
18 Official website of the National Internet Finance Association of China, www.nifa.org.cn/nifaen/2955866/2955892/index.html.
19 Ibid.

1. To organize, guide and urge members to implement national policies and guiding principles concerning internet finance, follow relevant laws and regulations as well as regulatory and normative documents issued by regulatory bodies to ensure compliance in their business operations;
2. To formulate and organize members to sign and perform self-regulatory conventions, encourage fair competence and defend the interests of the industry; conduct research and provide solutions for existing problems in the internet finance service market through communication and consultation; establish dispute and complaint handling mechanism as well as penalty and feedback mechanism for violation of the charter and self-regulatory convention;
3. To coordinate relations between members and between NIFAC (and its members) and relevant authorities; assist the governing bodies in implementing related policies and measures; act as a link and a bridge;
4. To organize industry status surveys, formulate industrial standards and business codes and provide consulting and suggestions for mid- and long-term development plans; collect, gather, analyse and publish basic industry data on a regular basis; comprehensive statistical survey, monitoring and early warning in the field of internet finance while providing information sharing and consulting services; conduct research into innovative products and services in the field of internet finance;
5. To actively collect, sort out and study cases of risks in the field of internet financial services, inform NIFA members and the general public of relevant risks;
6. To formulate business and technical standards and codes, code for professional ethics and standard for consumer protection, and supervise their implementation; establish a consumer complaint handling mechanism for the industry;
7. To provide continuous education and on-job training for professionals as required by the development of the industry to enhance the competence of professionals in internet finance;
8. To enable the function of overall promotion and education of the industry; popularize the knowledge of internet finance; promote the concept of inclusiveness and innovation of internet finance;
9. To organize workshops on business operations among members, mediate disputes among members, and inspect behaviours of members;