

## Where will Chinese Internet Finance Go?

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### Abstract

*Internet finance is rapidly rising, the landmark financial reform has attracted widespread attention. Internet finance poses a challenge on traditional financial institutions, financial business, the traditional financial mode and the traditional financial supervision mode. This paper introduces the development process of China's Internet finance, financial characteristics and the advantages and disadvantages of the Internet, and takes Internet financial product "balance treasure" for example, illustrates the Internet finance impact on traditional finance; Finally, we draw lessons from foreign Internet finance supervision experience and put forward effective measures, the regulation of the Internet finance in China to ensure that it develops safely and orderly, and injects fresh blood to the traditional finance.*

**Keywords:** Internet finance; Traditional finance; Risks; Balance treasure; Supervision

### 1. Background of China's Internet Finance

The generation of Internet has an effect on for many industries, finance will be no exception. In essence, finance itself is digital, in financial institutions assets, fixed assets ratio is very low, and the Internet have the same number of gene, all financial products can be viewed as data combination, all financial activities can be viewed as the movement of data on the Internet. At present, about 70% information in the whole society has been digitized, it is the foundation for big data applications in finance. If most of the individuals, businesses and other information are stored in the Internet, then based on the online information we can accurately assess these people or companies such as credit qualification, profit prospects. Looking from the future development of the real economy, enterprises have accumulated a large amount of data and risk control tools which can be used in financial activities. Not only that, sharing economy rises in some European and American countries, our country also appeared in some cases. E-commerce, sharing economy such as the Internet exchange economy is closely linked with Internet finance, which is both a data foundation for Internet financial application scenarios, the Internet finance and customer bases, it reflects the integration between the real economy and finance on the Internet.

Furthermore, traditional financial system is not sound in China, with the advancement of social reform, economic structure adjustment produced a large number of consumer demand for credit, a lot of them can't get enough from the formal financial, such as formal financial have not been able to service small micro enterprise effectively, in the case of margin protected, high profits, the enthusiasm of all kinds of capital into the banking sector. And long-term deposit interest rates are often run but subject to the control of inflation, the stock market for many years, combined with restrictions on the purchase in recent years, finance and investment needs of the ordinary people can not be satisfied. Equity financing channel not unobstructed, securities, fund, insurance and other products sales bound to banking channel, have an incentive to expand online sales channel. In the backdrop, China's Internet finance aims at meeting individuals and small micro enterprises financing demand, some creative projects of equity financing requirements, the citizens of the finance and investment demand.

Above all, the birth of the Internet finance is an objective demand of social economic development. Countries have realized the development of the Internet finance would be sharply unstoppable, so they push positive research for the development of the Internet finance in view of the existing problems and propose policies to support its development.

## **2. SWOT Analysis of Internet Finance Development**

### **2.1 Strengths**

(1) Internet finance relies on big electric business platform for data analysis, all registration information of suppliers and consumers and transaction behavior have complete records, and the record is true and can support each other. They can be used for clear analysis of credit standing of the enterprise and the customers. Effectively solve the asymmetric information and the individual credit problems. The financial service of supply and demand information are seen clearly, It lowers the threshold of the financial services clients which means it is very convenient and efficient.

(2) Management system of the internet finance is flexible, advanced technology is applied. Strong Interaction with customers. It has low cost and fast product information and it also can provide online real-time trading.

(3) Internet finance can carry out precise marketing and sales by big data. They use external data based on the accumulation of unstructured transaction data of customers and the enterprises themselves for the precise division with the customers which can take the initiative to recommend products.

(4) Internet finance products are superior than traditional industry financial business on cost especially. The management of the small retail cost is very low in internet finance. But many a mickle makes a muckle, and form a scale advantage.

(5) Internet finance improve the financing efficiency, transparency and participation, credit data is more abundant.

### **2.2 Weaknesses**

(1) Internet finance firms are lack of risk control system as traditional banks. Operation and risk management system are not yet perfect. They need a sound system of internal audit and strengthen the supervision of the internal control to be carried out orderly.

(2) Internet micro finance companies provide loans but not saving and mainly depend on the shareholders to provide capital operation. Limited by the restrictions of non-financial institutions identity, they can only have loan interest rate according to common enterprises, financing should not exceed 50% of the total registered capital.

(3) Internet peer-to-peer lending industries still have no barriers to entry, industry standards and regulatory gray areas. The current regulatory system can't completely cover, discipline construction system is still imperfect. Furthermore, internet finances lack of offline branches.

(4) Lack of personnel on-site inspections. It is difficult to cover all areas to expand their business in an all-round way. Internet finance enterprise s senior financial personnel relatively are in short.

### **2.3 Opportunities**

(1) The market needs convenient payment, lending and wealth management services.

(2) The market needs to have a low starting point, high returns, and low risk of financial products.

(3) Chinese domestic people have a stronger sense of savings. The mass of idle funds are more, they can be adds up to a huge number.

(4) The popularity of smart devices makes more and more people to surf online. In China, there are more than 500 million Internet users. They are definitely the potential customers.

(5) Through the Internet, financial product promotion cost is extremely low, it can rapidly transfer information to everyone.

### **2.4 Threats**

(1) The traditional financial enterprises are facing a transformation and the Internet are financial competitions, they include introducing the bank on the net, the network finance and e-commerce business.

(2) Internet finance enterprises are still at the stage of savage growth at present. Such as P2P lending ,while it has developed rapidly in recent years, but obviously they lack of policy regulation, if the change of policies and laws conflict with the emerging business, business development may face extinction.

(3) Internet finance problems such as credit risk, liquidity risk, take “balance treasure” as a example, its commitment is T+0 transaction, if the market fluctuates facing a large withdrawal requests, it is prone to run the risk.

### 3. Case Study Based on “Balance Treasure”

On June 13, 2013, the first Internet fund, Tianhong ZengLi treasure monetary fund has gone on sale in taobao, which has caused quite a stir in the banking industry. “Balance treasure” is launched by the third-party payment which is called Alipay, it is a balance of value-added service for individual users, it supports paying treasure to account balances, quick cash card payment (including cartoon) funds into balance treasure, customers can obtain certain benefits from the fund. Through the balance of treasure, users can not only get interest but also higher interest compared with the current deposit interest income. Balance treasure is simple in operation process, has high yield and flexible way to use. With the launch of the balance of treasure and its popularity, banks have also launched their own "baby" to contain the excessive growth trend of balance treasure.

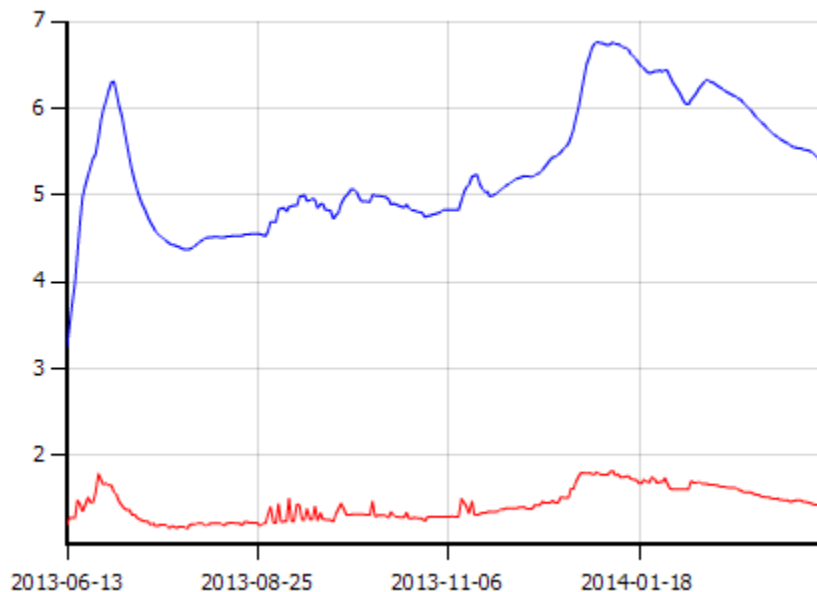
#### 3.1 The Internet Finance Impact on Traditional Banks, “Balance Treasure” as a Representative

First, the balance of treasure yields is higher than bank deposits, the risk is lower than wealth management products. According to the current domestic monetary fund annual yield, generally it is between 3% and 4%, and in the last year on June 20, alipay website given QiRi annualized yield reached 5.096%, far more than the average level of the domestic monetary fund. As of March 31, 2014, correspondent with the balance of the treasure, the yield of currency Tianhong ZengLi treasure is described such as table 1, we can make a assumption, if I had ten thousand dollars, if stored in a bank for a year ,the interest is more than 30 yuan a year, but put in the balance treasure, earnings can be three or four hundred one year. As a result, obviously we would choose to invest in balance of the treasure and the bank funds would be transferred gradually. This has caused a certain impact on the general business of the banks, deposits.

Second, based on the powerful advantages of platform and data, Alibaba began to challenge credit business of the traditional banks. Recently, Ali finance has launched financial credit card payments and the promise of "three days without reason to return rate" has been with the practical action highlighting the natural advantages of network financial .

Third, with the rapid development of information technology, the popularity of computers and mobile terminal, more and more people rely on the network, due to the virtual network, network users on the Internet behavior performance more directly to their own needs so as to provide more reliable data for Internet finance. At the same time, search engines, mobile payment, cloud computing, big data analysis and so on have been the supporters, the application of high and new technology to Internet finance reduces the risk and make the information into commercial value which is the advantage currently traditional commercial banks do not have .

**Table 1: Yields of Tianhong Zengli Treasure**



Red line: Thousands of income blue line: 7 days of yield

### 3.2 Arguments to “Balance Treasure”

A widespread social concern has been given to the emergence of the balance of treasure, it also appeared at this year's government work report that mentioned to guide and standardize the Internet finance. In previous meeting of the national committee, the central bank governor Zhou Xiaochuan also said that they would not ban balance treasure, but would further strengthen regulation and supervision.

In a recent meeting of the Bo Ao on BBS, China merchants bank, former President Mr Ma in the "Internet finance: to rational prosperity" points on the BBS when it comes to balance treasure, said: "we just leave it alone,there is no need to pay attention!"Mr Ma said that balance of treasure tapped the banks a lot of demand deposits, but the bank demand deposits belong to control itself, so banks more than anyone want open interest rate marketization."Bank deposits reduced 800 billion yuan in January, did all of them go to balance treasure?" He thinks bank disintermediation is inevitable, if after the producing of balance treasure, banks need to be at a higher price to absorb back the monetary funds from the inter-bank savings which is very unwise.The most direct way to solve this problem is let go of the currency rate.To some extent, the balance treasure forces banks to reform and promote market-oriented interest rate.

Mr Ma's point of view is also supported by the chairman of China Min Sheng bank Dong Wenbiao.He said more bluntly: "no matter how the Internet develops, interpersonal, face-to-face communication is always the main form of communication." Also,Mr Ma said to MaYun that "don't all revolution, you don't have that skill."He thought that balance is actually a treasure hype, and the hype product of MaYun and the media.

Yale university professor Chen Zhiwu joined the "siege" of balance treasure.He accused the balance treasure to take advantage of loopholes of the regulatory rules."Babies" successes are more to drill a loophole in the rules than because the use of the Internet. Balance treasure has never faced in advance or early exit agreement deposits so far, from a regulatory point of view, once happened a liquidity event, the impact on the entire product is fatal.

On balance treasure one-sided "targeted" sound, impartial analysis are given by a professor from Chang jiang graduate school.In his view, the balance of treasure is not a financial innovation, but the sources of innovation, the balance is essentially a monetary fund.Monetary fund actually has existed since 2004 in China, now it is only through the combination with Alipay and has the channels of innovation. We can not say that because no regulation on the Internet finance, balance treasure is to take advantage of loopholes of the regulatory rules. As a kind of monetary fund, the product itself is not qualitative, it is actually a very mature financial products.

Reflected behind balance treasure to become the focal point is the appearance of the Internet finance. Internet financial leader Liu Jin put forward by supervising innovation with the way of innovation, Internet by means of the Internet. The Internet financial innovation can reduce cost, improve allocation efficiency and increase liquidity, its positive role is far from real show. During the process, it is more in need of the market on the combination of self-discipline and supervision innovation, we need to pay more attention to policy and tolerance to Internet finance.

## 4. Regulatory Strategy of the Internet Finance

### 4.1 Five Principles of Internet Financial Regulation

China people's bank will jointly with the relevant departments further explore and improve the regulation and promote the healthy development of the Internet finance in accordance with the general requirements of "encourage innovation, risk prevention and mitigation and the healthy development".

The first is that Internet financial innovation must adhere to the essence of financial services entity economy requirements, reasonable grasp the boundaries of innovation and strength. Including Internet finance, financial innovation must be market-oriented, in order to improve the financial service ability and efficiency, and better serve the real economy as the fundamental purpose, not away from financial regulation and the service of the real economy. Internet network of financial payment should always adhere to the service for e-commerce development and provide society with small, quick pay service; P2P and Crowd funding suggest to adhere to platform function as they may illegally absorb deposits, raise funds in the name of the Internet finance.

The second is that the Internet financial innovation should obey the overall requirements of macroeconomic regulation and financial stability.

Everything including Internet finance and financial innovation should be conducive to improve the efficiency of resource allocation, it is conducive to maintain financial stability, to steadily promote the reform of interest rate marketization, it is also advantageous to the central bank regulation of liquidity to avoid certain financial market prices fluctuated violently from the financial business innovation, increasing the real economy, the cost of financing can not therefore affect liquidity in the banking system transformation, which lower the credit in the banking system on the real economy supporting ability.

The third is to earnestly safeguard the legitimate rights and interests of consumers. Internet financial enterprises who start the business should have sufficient information disclosure and risk disclosure, any promised benefits by direct or indirect methods which misdirect consumer are banned. To start any business, all dealing with protection of the rights and interests of consumers should make detailed arrangements.

The fourth is to maintain the market order of fair competition. Under the condition of market economy, fair competition is the necessary requirement to ensure that market is of decisive role in the allocation of resources. The moved to online, offline financial business must abide by the line of the existing laws and regulations and also must abide by the capital constraints. Any competitors shall comply with the requirements of the anti-unfair competition law and shall not use any way to denigrate other competition.

The fifth is to deal with the relationship between government regulation and self-discipline management, give full play to the role of the industry self-discipline. To promote the establishment of "China's Internet finance association", give full play to the association of self-discipline management role, to promote a unified industry service standards and rules, and guide the Internet finance enterprises to fulfill social responsibility. Large institutions in Internet finance industry should play a model leading role in establishing the industry standard, servicing the real economy and the social public.

#### **4.2 Internet Financial Regulatory Suggestions**

Around the world, because of the Internet finance is in the process of development, the financial supervision has not formed a systematic and specialized Internet financial supervision system. But looking at the Internet financial development trend and the characteristics of the business risk main developed countries such as Europe and the United States, they have began to strengthen and perfect the financial supervision of the Internet, on the basis of using the experience of developed countries, this paper puts forward some important suggestions.

One suggestion is to innovate financial supervision train of thought and increase regulatory quality and efficiency.

The first thing is to correctly handle the relationship between management and innovation. Compared with the traditional finance, Internet finance is more flexible and more convenient, more innovative and risk. For now, China's Internet financial market has just started, the impact on the financial market is not fatal, excessive regulation will stifle innovation and hinder the diversified development of financial markets. Regulation in emerging markets, therefore, should be solved in the process of business innovation in the new situation and new problems to maintain the benign development of market. In the process of actual operation, we should highlight the regulatory predictability and prevent the spread of the potential risks.

Secondly, we should handle the relationship between the risk prevention and industry development. Looking from Internet financial enterprise actual operation in our country, some companies do not put the business risk prevention in an important position, risk awareness is relatively weak. To some extent, they emphasize more on business development rather than risk prevention. Minority enterprises focus on marketing and development of operations, ignoring the compliance of business management, even at the risk of irregularities to achieve short-term performance. P2P network platform collapse phenomenon occurs frequently, so we need attach great importance to the cause.

Finally, we should deal with the relationship between separated regulation and mixed operation. In China, we take pattern differentiated regulation of financial industry to ensure the economic system transformation during the stability of the financial system in our country. For the steady development of the financial sector and effectively guard against financial risks, it has played a positive role. But looking from the operation mode of Internet finance relevant enterprises in China, the modern financial industry greatly ignore the division of labor and specialization, mixed management trend is increasingly obvious, therefore there is need to be more clear to its financial regulatory responsibilities and rules of the business to enhance pertinence and effectiveness.

Another suggestion is to perfect the regulatory measures to promote the healthy and orderly development of the market.

At the regulatory level, we should adopt the policy of "appropriate hydrophobic, unfavorable blocking" through the channels of legalization, sunshine and standardization to promote development of the Internet financial market healthily and orderly.

First of all, we need to have a clear legal status and regulatory responsibilities. We should clear the nature of the Internet financial institutions in the form of legislation and law, establish a financial supervision and regulation department and local government departments doing their job in the supervision mechanism of mutual cooperation. From the Internet permission establishment, business operation of financial institutions to site transfer of deposit money and daily management, various aspects should be under the implementation regulation. Furthermore, to strengthen the construction of Internet financial markets and exit system through the administrative licensing management to raise barriers to entry, specify the Internet financial institutions registered capital, operating rules and the standards of the construction of internal control system. At the same time, the market exit mechanism should be established in order to achieve market integration and natural evolution and promote the Internet financial statistical monitoring, anti-money laundering supervision and construction of social credit system and related work. Through strengthening the dynamic monitoring of Internet financial capital flow, a reasonable guide should be given to social capital flow to make relevant financial business in line with the requirements of macroeconomic regulation and control. We can request Internet financial institutions in anti-money laundering supervision in accordance with the anti-money laundering regulations. We can develop the personal credit rating information service market to solve the problem of asymmetric information in the Internet finance. The last is to strengthen the financial consumer education and protection work. On the one hand, we should attach great importance to the education of financial consumers and investors and strengthen the consciousness of risk prevention. On the other hand, we should investigate violations to regulate Internet financial markets.

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