Internet Financial Regulation and Financial Consumer Protection

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Abstract. As a new type of financial industry, the regulatory policy of internet finance is a fundamental to its development, which involve in not only the steady development of financial market, but also the maintenance of the legitimate rights of internet financial consumers. The paper first defined the definition of internet finance, and then classified the models of internet financial industry. Based on the analysis of the prudential supervision, functional regulation and conduct regulation of the traditional financial industry, this paper discussed the measures of internet financial consumer protection. Finally, the paper designed the regulatory framework of internet finance in China.

Introduction

Since 2012, Internet Finance rapid developing has been widespread concern in China, especially the "Alipay" and other third-party payment, money market fund product such as Yu'E Bao, which stirred up the financial markets. All kinds of Internet Financial products are popular in the domestic market, such as P2P, crowd-funding, and online financial products, which lead to the loss of a large number of savings deposits of commercial banks in short term. After the rapid development of 2014 and 2015, the interest rate of money market fund products were greatly reduced, and online financial products continued to emerge fraud. The Internet Financial industry exposure exposed. How to strengthen the supervision of the Internet Financial industry, and protect the interests of financial consumers, thereby promoting the healthy and stable development of the Internet financial industry, is particularly important.

The Classification of Internet Finance

The Definition of Internet Finance. As a new field, Internet Finance is still in development, there is no clear definition.

In the United States and Europe and other countries and regions, "network finance" or "E-finance (electronic finance)" usually appears in the literatures, there is no "Internet Finance ". Allen believes that E-finance is a financial activity on the basis of communications, information networks and other networks, including electronic transactions, online banking and the provision and clearing of financial products and services such as insurance, mortgages [1]. Electronic finance is an emerging field combining with traditional financial industry and Internet. It is not simply internet technology finance, but the finance model on the basis of internet-related technology and network thinking.

XIE Ping, WU Xiaoqiu and others believed that Internet Finance is a new type of financial industry in China. XIE Ping [2] believed that "Internet Finance is different from the indirect financing of commercial banks , but also different from the direct financing of the capital market, is a third financing model." WU Xiaoqiu [3] believed that "Internet Finance is the new financial industry with the corresponding financial function chain, which based on the internet spirit and the internet as a platform and cloud data integration, also known as the third financial industry.

People's Bank of China and other 9 ministries jointly issued "the guidance to promoting the healthy development of Internet Finance" in October 2015 [4]. The guidance pointed out that the Internet finance is a new financial business model that the traditional financial institutions and internet companies use internet technology and information and communication technology and achieve financial intermediation, payment, investment and information intermediary services.

Comparison of the definition of e-finance abroad and the guidance about internet finance, we can find out that the two definitions are similar. After a clear definition of internet finance, it is necessary to clarify its classification in order to facilitate the professional and comprehensive supervision.

The Classification of Internet Finance. As Internet finance is still in the continuous development, its classification is different.

According to the difference in payment and information processing and resource allocation, XIE Ping divided Internet finance into eight main types: (1) Internet of traditional finance; (2) Mobile payment and the third-party payment; (3) Internet currency; (4) Credit Investigation and network loans based on Big Data; (5) Insurance based on Big Data; (6) P2P credit; (7) equity Crowd-funding; (5) The application of Big Data in securities investment.

From the elements of the Internet platform and financial functions, WU Xiaoqiu classified Internet finance into four categories: (1) third-party payment, mainly the Internet payment and mobile payment; (2) network financing; (3) Network investment; (4) network currency.

According to the scope of business, WU Xiaoling[5] divided Internet finance into four aspects: (1) Clearing business related with e-commerce; (2) Small business loans based on marketing information; (3) Standardized financial product Transaction relied on the payment account; (4) Information platform for both debit and credit sides.

The guidance issued by The People's Bank of China and other 9 ministries pointed out that Internet finance includes Internet payment, network lending, equity crowd-funding, Internet fund, Internet insurance, Internet trust and Internet consumer finance. The file classified Internet finance by institution. Traditional financial institutions were responsible for constructing innovative Internet platform including Internet bank, Internet security, Internet insurance, Internet fund and Internet consumer finance. Internet companies were responsible for setting up the Internet Payment institutions, Internet lending platform, equity crowd-funding platform, and online sales platform of financial products. E-commerce enterprises were responsible for developing E-commerce supply chain financial services.

Combined with the Internet features and functional financial perspectives, the paper divided Internet finance into the following types: (1) Internet payment, including the third-party payment and online banking payment; (2) Internet direct financing, including P2P network loans, equity crowd-funding; (3) Internet indirect financing, including Internet bank, Internet microfinance and Internet consumer finance, etc.; (4) Internet financial products sales, including Internet securities, Internet insurance, Internet trust, Internet fund and Internet sales of financial products, etc.; (5) Information service and ancillary services of Internet financial market, including all types of Internet financial information platform (Portal) and technical services to provide various types of Internet financial products and market information and related services, such as big data storage, network and information security maintenance, credit rating, accounting, auditing, legal, consulting and intermediary services.

In addition, Internet finance can also be more concise divided into Internet payment, Internet financial credit, Internet financial sales and information and services of Internet finance.

Internet Financial Regulatory Principles

Internet finance is a new type of financial business relying on information communication and its derivative technology, but its essence is still finance. Therefore, Internet finance regulation should also seek its regulatory approach from the traditional financial regulation theory and practice. In the process of financial regulation practice, there are various kinds of regulation methods, namely prudential regulation, functional regulation and conduct regulation.

Prudential Regulation. Since the financial crisis in 2008, Basel III emphasizes that capital requirements and risk management are closely linked, puts forward higher requirements to the capital adequacy ratio, leverage, capital quality, liquidity, and information disclosure level. In the aspect of financial regulation, the author puts forward the combination of macro prudential regulation and micro prudential regulation, and strengthens consumer financial protection [6].

Macro prudential regulation is a regulatory model which mainly reduces the economic cost of financial turmoil and ensures financial stability. Macro prudential regulation treats the whole financial system as a regulatory object [7]. Macro prudential regulation is carried out mainly from two dimensions: the cross industry, cross institutional dimension to consider the systemic risk among different agencies due to the mutual influence; and time dimension to pay attention to the dynamic change of the financial risk [8]. Accordingly, Basel III has taken the following measures: first, to strengthen systemically important financial institutions supervision (cross agency regulation); second, to strengthen cross time supervision (counter-cycle regulation).

Micro prudential regulation is mainly to control the individual financial institutions or business risks, to ensure the stable operation of the company and protect the interests of investors. Micro-prudential regulation treats a single financial institution or business as a regulatory object. Micro prudential regulation uses prudential regulatory indicators to regulate relevant financial institutions, such as capital adequacy, asset quality, loan loss reserves, risk concentration, connected transactions, asset liquidity, risk management, and internal controls, etc.

Functional Regulation. Functional regulation is a regulatory model proposed by Merton Robert from the perspective of functional finance [9] [10]. Financial function theory believes that is the function, rather than institutions, is the cornerstone of the financial market [11]. Although the financial system varies and evolves over time and space, its six basic economic functions are generally stable. With the development of financial technology, the change of consumer's financial knowledge level and the change of regulatory environment, the cost of financial institution and financial market will change. The mutual substitution between financial institution and financial market will occur, it is financial innovation. In the process of continuous financial innovation, the boundaries of financial institutions and financial markets are constantly changing. The range of financial products and services provided by financial institutions is constantly changing. New types of financial institutions are emerging. Traditional institutional supervision mode is facing with serious situation of regulatory overlaps and regulatory vacuum coexistence. The functional supervision emphasizes on cross-product, inter-institutional and cross-market financial supervision. The supervisory authority should not focus on financial risks within various industries. It advocates that the authority establish a unified regulatory body, coordinate the regulation of different financial sectors and departments, and achieve the overall supervision of the financial industry so as to improve the efficiency of financial regulation. Therefore, the transition from institutional regulation to functional regulation will be the inevitable trend.

Conduct Regulation. Michael Taylor proposed twin peaks of financial regulation in 1995, and behavior regulation has entered the field of financial regulation [12]. Taylor believed that the goal of financial regulation should be twin peak target. One objective is prudential regulation, which aims to maintain the sound management of financial institutions (micro prudent) and the stability of the financial system against systemic risks (macro prudent). Another objective is conduct regulation, which is aimed to improve financial efficiency, correct opportunistic behavior, fraud and unfair trade of financial institutions, and protect the interests of financial consumers. Prudential regulation is aimed at the safety and sound development of financial institutions and the stability of the financial system, while conduct regulation aims to ensure the transparency and fairness of financial market and maintain financial consumer confidence.

Conduct regulation is mainly aimed to supervise various financial institutions and service agencies and establish the fair trade, anti-fraud misleading, consumer dispute settlement, privacy protection and other system, which protect the legitimate rights and interests of consumers, such as security rights, the right to know, the right to choose, the right to fair trade, claim, the right to education, etc. Conduct regulation mainly supervises two kinds of trading behavior: between the financial institution and the natural person; between the financial institution and the financial institution or the non financial enterprise. Among them, the trading behavior supervision between the financial institutions and the natural person is also the consumer financial protection. Through on-site inspection, assessment and disposal measures, conduct regulatory authority assure the transparency of financial market and maintain financial consumer confidence.

Financial Consumer Protection

Compared with the general commodity market, financial market institutions, market behavior and service rules are more professional, complexity and innovation. Financial consumers are different from the ordinary consumers, as there is a serious information asymmetry in financial transactions [13]. The experience and maturity of financial consumers are various widely. They are more for the trust and blind obedience to financial institutions and have the thought of free-ride. The 2008 financial crisis proved that micro prudential regulation, which mainly focuses on the risk management of institutions and businesses, has great flaws. Because of the neglect of financial consumer protection, it resulted in a huge loss of financial consumers, and impact seriously on the world economy. Even now the world economy has not yet out of the quagmire.

Due to the characteristics of fast transmission and low cost, Internet finance makes full use of the breadth and depth of the network, and its service scope and boundary are far beyond the traditional financial institutions. The financial nature of the Internet finance has not changed, and the root of all kinds of financial risks is the asymmetric information in financial markets, the Internet financial, by the use of information and communication technology, can reduce the degree of information asymmetry, this is beneficial. However, Internet financial institutions have a natural advantage over ordinary financial consumers in terms of information access and analysis, product pricing and transactions. At the same time, product innovation and transaction complexity has further strengthened their dominant position.

As a provider of the products and services with absolute advantage, the core goal of the Internet financial institutions is to maximize profits. Driven by profit-driven motives, it is possible to aggravate the financial consumer's market weak position. Therefore, to strengthen financial consumer protection is not only the goal of financial regulation, but also the premise of the sustained and stable development of Internet finance.

After the financial crisis in 2008, financial consumer protection has been paid attention to by all parties. The World Bank released the “Good Practices for Financial Consumer Protection” in 2012 [14], covering banking, securities, insurance, and non-bank financial institutions, applied to the consumer protection in the entire financial services field. The work presents eight empirical recommendations. G20 released the "High-level Principles on Financial Consumer Protection" in 2011, including ten principles, covering financial consumer protection, financial regulator, responsibility of financial services institutions and authorized agencies, information disclosure, financial consumer education, protection consumer property and information from fraud and abuse, complaint settlement and relief mechanisms [15]. The UK FCA issued “The FCA’s regulatory approach to crowdfunding over the internet and the promotion of non-readily realisable securities by other media，PS14/4” in 2014, strengthen Internet finance regulation. For consumer protection in Internet finance, FCA has proposed seven basic regulatory rules, such as minimum prudential capital standard, information disclosure, information reporting, customer money protection, contract cancellation right, loan management after platform collapse and dispute settlement mechanism.

Overall, Internet financial consumer protection can be carried out from the following aspects: market access system, information disclosure and information reporting system, consumer privacy and data protection system, security mechanism and dispute settlement mechanism, financial education and Evaluation system, market fair competition and industry self-discipline system.

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Internet Financial Regulatory Framework

As an emerging industry, Internet finance makes full use of information and communication technology and its derivatives (such as large data, cloud computing, etc.) to carry out financial-related business. Internet financial industry involved in various business areas of traditional finance, in the process of providing services to financial consumers, different types of Internet financial models assumed different functions. Only clear functional orientation different types of Internet financial models, Internet financial industry is possible to achieve healthy development.

From the micro perspective, market subject, market behavior and regulatory rules of Internet financial industry are more professional and complex, innovative. The products and services provided by the Internet financial market have the characteristics such as cross product, cross institution and cross market. Therefore, the regulation of Internet finance also needs to adopt cross-product, cross-institution, and cross-market functional regulation. Internet financial institutions are most likely to take advantage of their information superiority, mislead or even deceive consumers, and information transparency is the key foundation for the development of Internet finance. Thus, it is necessary to strengthen conduct regulation about Internet finance, improve the transparency of market information, and maintain financial consumer confidence. From the macro perspective, as a part of the financial system, the stability of the Internet finance also affects the stability of the whole financial system to a certain extent, so it should be included in the scope of prudential regulation.

Based on the above analysis, the Internet financial regulatory framework can be shown in Fig. 1.

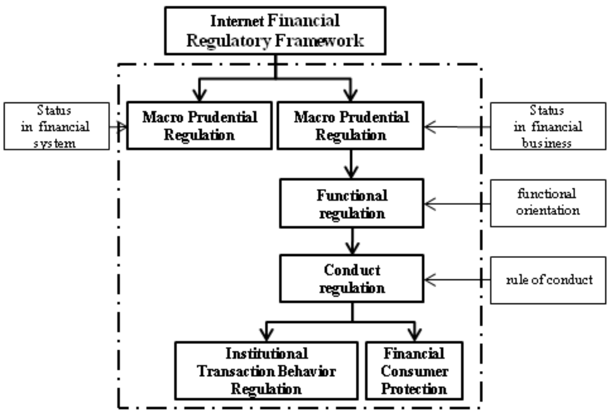

Figure 1. Internet financial regulatory framework

As shown in Fig. 1, in Internet financial regulatory framework, it should be first determined the status of Internet finance in financial system (macro-prudential supervision level) and the status of Internet finance in financial business (micro-prudential supervision level). Macro-prudential regulation strengthens the Internet finance supervision from the industry (or organization) dimension (inter-industry) and time dimension (dynamic change) and ensures the stability of the financial system; While the micro-prudential regulation strengthens the Internet finance supervision from the perspective of operation and institutions and ensures the business stability of operation and institutions.

Secondly, in order to prevent the overlap regulation and vacuum regulation, according to the principle of functional consistency, the functional orientation of various Internet financial industries is defined. Then, the regulators take appropriate functional regulation measures to different types of Internet financial industry, and improve the traditional regulation rules based on the characteristics of the Internet finance.

Finally, once identified the functional orientation of specific Internet finance industry, it was very important to draw conduct rules and conduct regulation and to take appropriate measures to enhance the industry safety.

In the framework of micro-prudential regulation-functional regulation-conduct regulation, functional regulation is the key link as a bridge role. The significance is that the function of Internet finance industry is defined, and then it is possible to adopt the policies of micro-prudential and micro-prudential regulation to those cross-product, inter-institutional and cross-industries financial businesses. Only in this way can take appropriate and effective consistency regulation, can avoid regulatory vacuum and prevent arbitrage and fraud. And only determining the function of Internet financial products or services, it is possible to clear their conduct rules and to fully protect the interests of financial consumers.

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