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**Country Profile: China**
**Chambers FinTech**

**DaHui Lawyers**

## I. Introduction

DaHui Lawyers' robust FinTech practice comprises a wide variety of representations, catering to both local and international clients. DaHui has assisted numerous leading Chinese FinTech firms in their overseas listings on the NYSE and HKEX, and actively represents domestic private equity and venture capital funds in their cross-border investments in emerging FinTech providers across the globe. From our wide exposure in China's FinTech market, we have witnessed first-hand many rapid changes to China's legal and policy landscape surrounding the FinTech sector, with particular impact across some notable subsectors. We believe that drastic policy changes will continue to develop in this space throughout 2019, presenting a FinTech market that will see both challenges and opportunities ushered in by this trend.

## II. Overview of China FinTech Landscape

The rich dynamism of China's overall FinTech market is best demonstrated by the current state of developments within four key subsectors that DaHui is actively involved in: (i) Payment Services; (ii) Online Lending; (iii) Intelligent Investment Advisory Services; and (iv) Blockchain & Cryptocurrency. By examining an overview of these subsectors against the spate of new regulations and policies that Chinese authorities have promulgated in recent years, one can detect key trends about where China's FinTech industry is likely to be headed in 2019.

<u>Payment Services</u>

The third-party (*i.e.,* non-bank) payment service market in China is in many ways a fully developed market. The People's Bank of China ("**PBOC**") serves as the key regulatory body of third-party payment activities in China, as it issues the third-party payment licence ("**Payment Licence**") which permits licence holders to engage in online, mobile and offline payment services. China has already grown to be one of the largest contributors to the global payment services market, with giant domestic service providers like WeChat Wallet and Alipay playing an entrenched role in this industry, far beyond China's shores. In addition to the primary regulatory functions performed by the PBOC, China's State Administration of Foreign Exchange ("**SAFE**") also regulates the cross-border component of China's payment industry, managing its own payment licence ("**SAFE Payment Licence**") regime which allows licence holders to receive/pay foreign currency directly and to convert such funds between onshore Chinese yuan ("**CNY**") and foreign exchange. Alongside SAFE, the PBOC also oversees cross-border CNY payment approvals via its own cross-border licence ("**CNH/CNY Payment Licence**"), which allows licence holders to make cross-border payments

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and collections denominated in CNY and offshore Chinese yuan ("**CNH**"). Taken together, obtaining a Payment Licence from the PBOC is a precondition for both obtaining a SAFE Payment Licence and a CNH/CNY Payment Licence.

While the PBOC previously restricted foreign participation in the Chinese payment industry by prohibiting any foreign-invested entity from obtaining a Payment Licence, it is worth noting a few of DaHui's recent representations that illustrate possible liberalisation in this space. One of our clients successfully participated in a recent round of fundraising by Ant Financial, the parent company of Alipay, and part of the funds raised were notably contributed by foreign investors. Similarly, we have also represented World First, a UK-based global payment service provider, which has already lodged its Payment Licence application to the PBOC and is on track to become the first foreign entrant in China's domestic payment services industry. Judging by these two cases, it is foreseeable that regulators could gradually be opening up China's third-party payment service market to foreign investors.

<u>Online Lending</u>

Another key subsector of the Chinese FinTech market comprises the mosaic of online lending platforms which operate as intermediaries between lenders and borrowers, online microcredit companies providing direct lending, and auxiliary service providers such as intelligent individual credit rating services. Of all market players, online lending platforms hold a pivotal role in the Chinese FinTech market and have attracted much of the attention of commentators with an eye on this industry. The regulation of the online lending subsector is still generally in quite a juvenile stage compared to that of traditional financial institutions such as commercial banks, but the subsector has grown and proliferated rapidly as Chinese consumers/borrowers seek substitutes to traditional banking and new methods of borrowing/lending that were previously unavailable. As a result, the market is currently witnessing a continuous evolution marked by changes to relevant laws and regulations, as regulators strive to tackle challenges posed by this dynamic and ever-growing subsector.

Since 2015, the Chinese government and key regulatory authorities—including the PBOC, the Ministry of Industry and Information Technology ("**MIIT**"), the China Banking and Insurance Regulatory Commission ("**CBIRC**", a combination of the former China Banking Regulatory Commission and China Insurance Regulatory Commission), and other special regulatory task forces—have promulgated a number of laws, regulations and policies aimed at tightening up the rules and supervision of the online lending industry. The effect of such regulations has been to dramatically reshape the scope of business allowed under the online lending banner and to reformulate its respective compliance landscape. For example, the *Notice on Regulating and Rectifying "Cash Loan" Business* ("**Circular 141**") jointly issued by the Internet Finance Rectification Office and the Online Lending Rectification Office in December 2017 has essentially prohibited the so-called "cash-loan" business model that previously played a major role in some online lending platforms' portfolios.

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Relevant authorities have also issued a series of regulations that impose record-filing obligations on online lending platforms, requiring certain information to be reported to local authorities.

Along with the tightening of regulation and supervision over this subsector, the market has also seen a number of Chinese online lending giants (*e.g.,* Qudian, Paipaidai, VCredit, and most recently, Weidai) successfully land IPOs on the NYSE and HKEX. Such foreign listings have allowed the healthiest players in this space to demonstrate their relative strengths in contrast to the collapse of dozens of other online lending platforms which were unable to ratify existing compliance issues and cashflow problems. As the deadline for new inspection requirements nears in December 2018 and online lending platforms strive to satisfy their record-filing obligations, the online lending industry will undoubtedly see even more winners and losers throughout 2019.

<u>Intelligent Investment Advisory Services</u>

The Chinese FinTech market has also seen the rise of a variety of intelligent investment advisory service providers, from online trade brokerage and information platforms such as Tiger Brokers and Snowball to robo-investment advisors and asset managers such as Licai Mofang and Latte Bank. Unlike other subsectors of the FinTech family, China's intelligent investment advisory services sector is subject to a host of long-existing rules that restrict Chinese start-ups from directly engaging with end-users/investors. For example, the China Securities Regulatory Commission ("**CSRC**") promulgated its *Interim Rules on Strengthening Supervision on Utilising "Stock Recommendation Software"* back in 2013, which defines the use of "Stock Recommendation Software" as one way of providing securities investment advisory services to investors, thereby triggering the CSRC's overarching regulations on offering investment advisory services, which requires a securities investment adviser licence. Likewise, the online sale of securities products such as interests in public securities funds has been classified as a CSRC-regulated fund selling service, which requires a fund distribution licence (Chinese FinTech giants such as Baidu, Tencent and Alibaba have each acquired such a licence as of 2018). The online brokerage or trade of securities likewise requires relevant licences issued by the CSRC.

Given the regulatory and licensing hurdles within China's investment advisory services space, it is not easy for start-ups without appropriate financial licences (see more details below) to offer or directly participate in intelligent advisory services within China. Instead, we have seen a number of companies opt to provide such services in co-operation with licensed financial institutions.

We have also seen a number of online investment advisers assisting Chinese clients to invest in foreign securities markets (*e.g.*, foreign ETF products) while providing pure information services in China which do not trigger the above regulations. Notably, this latter model only applies to Chinese clients who have legally available funds outside

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China and is therefore not technically a direct participation in the Chinese financial advisory service market.

<u>Blockchain & Cryptocurrency</u>

Chinese regulators have exhibited a divided attitude when it comes to blockchain technologies and cryptocurrency exchange/initial coin offerings ("**ICOs**") in China, sensing on one hand (and even encouraging) the benefits of a wider integration of blockchain applications in the FinTech sector and overall Chinese economy, while at the same time taking a hard line against cryptocurrencies and ICO fundraising. In 2017, regulators outright banned cryptocurrency exchanges and ICOs in China, and also imposed severe restrictions on the use of cryptocurrencies and relevant trading services. Although some market players have continued to conduct limited cryptocurrency operations in China, these actions continue to attract increased government scrutiny, with regulators vowing to impose additional restrictions and strengthened monitoring of cryptocurrency-related activities throughout the near future.

In contrast, the use of blockchain technology beyond its cryptocurrency applications has been welcomed and even encouraged by regulators. On 19 October 2018, the Cyberspace Administration of China ("**CAC**") issued a nonbinding draft form of regulations for public consultation, the *Provisions on Administration of Blockchain-based Information Services*, which would set clear procedural guidelines for providers of non-cryptocurrency, blockchain-based services within China. The PBOC also has undertaken a large-scale initiative to develop a blockchain-based, interbank trade finance platform in China, while the Supreme People's Court has ruled that blockchain evidence is a legally admissible form of evidence in Chinese courts. Following closely behind these developments, some traditional players in China's financial sector (*e.g.*, commercial banks) have invested heavily in blockchain-driven technologies that will carry lasting implications on the Chinese FinTech sector.

**III. Policy Trends**

In addition to the general trends and subsector overviews above, there is a wide array of more specific policy trends that are likely to shape the course of China's FinTech market throughout 2019. Key developments that will continue to impact China's FinTech sector are detailed below.

1. Payment Service Providers Cut Direct Ties to Banks

In light of compliance issues and potential risks posed by direct fettering of client funds by payment service providers, the PBOC orchestrated the establishment of the NetsUnion Clearing Corporation ("**NUCC**") in 2017, which serves as the operator of a new online settlement platform for non-bank payment institutions ("**China NetUnion Platform**"). The China NetUnion Platform aims to cut off all direct transactions

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between third-party payment service providers and commercial banks. Along these lines, the PBOC issued a *Notice on Non-bank Payment Organisation Network Payment Operations Shifting from the Direct Model to China NetsUnion Platform* in August 2017, which requires that all Chinese online payment transactions handled by payment service providers be processed through the China NetUnion Platform, which is intended to serve as the sole and centralised nexus directing such transactions to commercial banks starting from 1 July 2018.

On 29 June 2018, the PBOC further issued the *Notice of the General Office of the People's Bank of China on Matters concerning Complete Centralised Deposit of the Funds of Pending Payments of Clients of Payment Institutions*, which requires all payment institutions to gradually increase the amount of centralised funds held by such institutions that are taken from the pending payments of clients, and to realise 100% centralised deposits by 14 January 2019. In other words, third-party payment platforms will be required to hold all client funds in centralised fund management accounts and will be deprived of access to such funds for other business purposes (with limited exceptions) starting from 14 January 2019.

2. Record-filings of Online Lending Platforms

As mentioned above, all online lending platforms are now required to complete record-filing obligations with local authorities at its operator’s home province. The key regulations pertaining to such record-filing obligations include:

•<u>Record-Filing Guidelines</u>: In October 2016, the China Banking Regulatory Commission (“**CBRC**”), the MIIT, and the State Administration for Industry and Commerce (“**SAIC**”, the predecessor of the State Administration of Market Regulation) jointly issued the *Guidelines on the Administration of Record-filings of Online Lending Information Intermediaries* (“**Record-Filings Guidelines**”), which establish and improve the record-filing mechanisms for online lending intermediaries.

Pursuant to the Record-Filings Guidelines, newly established online lending information intermediaries must make certain record-filings with the local financial authorities after initially obtaining a business licences. For online lending intermediaries that were established prior to the effective date of the Record-Filings Guidelines, the local financial regulatory authorities were permitted to accept record-filings applications submitted by qualified online lending information intermediaries, or online lending intermediaries that received final clearance from such authorities that their rectification measures of any existing compliance issues were sufficient.

• Circular 57: Additionally, the *Notice on the Rectification and Inspection Acceptance of Risk of Online Lending Intermediaries* (“**Circular 57**”), required online lending information intermediaries to complete their record-filing with local authorities no later than the end of June 2018. The P2P Inspection Notice (discussed below) further

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extended this deadline and requires online lending platforms to complete self-inspection by the end of December 2018, before completing their record-filings.

•P2P Inspection Notice and Compliance Checklist: In August 2018, to provide further clarification on compliance and record-filing requirements, the Leading Group for the Rectification and Inspection Acceptance of Risk of Peer-to-Peer Online Lending Intermediaries issued the *Notice on Launching Compliance Inspection on Peer-to-Peer Online Lending Information Intermediaries ("**P2P Inspection Notice**")* and the *Compliance Checklist for Online Lending Information Intermediaries as specified in the P2P Inspection Notice* ("**Compliance Checklist**"). Together, these two regulatory developments provided much clarity on issues that had been outstanding as a result of the prior regulatory promulgations.

Notably, the P2P Inspection Notice requires each online lending information intermediary to complete the following compliance inspection procedures by the end of December 2018: (i) a self-inspection; (ii) an inspection conducted by local and national Internet Finance Association authorities; and (iii) verification conducted by the government rectification office in charge of online lending.

The compliance inspections are primarily focused on whether online lending information intermediaries: (i) conduct any business activities other than those of an information intermediary (such as a credit intermediary); (ii) form any capital pools or make any payments on behalf of users; (iii) conduct any direct or indirect self-financing; (iv) provide any guarantee to lenders; (v) provide any "rigid payments" to lenders; (vi) conduct risk evaluation of lenders and make hierarchical management decisions based on such lenders; (vii) fully disclose borrowers' credit risk related information to lenders; (viii) strictly follow relevant small-amount and scattered manner patterns of activity when participating in network-based lending; (ix) raise funds by issuing financial products in the form of wealth management products (on their own or through their affiliates); and (x) attract borrowers or lenders by suggestions of high profits or other (potentially or actively misleading) methods.

The P2P Inspection Notice also requires each online lending information intermediary to conduct self-inspection procedures and deliver a self-inspection report to its competent online lending rectification office, which then appoints a local internet finance association to conduct internet finance association inspections. Meanwhile, the Compliance Checklist provides a helpful compliance roadmap for online lending information intermediaries to ensure they comply with all such requirements.

•Self-Discipline and Inspection Circular and Issue List: On 22 August 2018, the National Internet Finance Association of China ("**NIFAC**") issued the *Circular on Conducting the Self-Discipline and Inspection by the Peer-to-Peer Online Lending Information Intermediaries* ("**Self-Discipline and Inspection Circular**") which provides that the NIFAC will organise internet finance association inspections on members of the NIFAC. Members of the NIFAC must accurately fill out and submit

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self-inspection and self-rectification reports according to *the Self-inspection and Self-rectification Issue List regarding the Member of the Peer-to-Peer Online Lending Information Intermediaries* ("**Issue List**"), which was released by the NIFAC on 29 August 2018, in order to report the compliance status of their systems and business operations to the NIFAC and its local counterparts. The Self-Discipline and Inspection Circular and the Issue List provide a number of other clarifications related to the internet finance association inspections, including, for example, that members of the NIFAC must connect their systems to the NIFAC Online Finance Inspection Platform and duly report statistics and information as required by regulators. The reports for the self-inspections and internet finance association inspections must be delivered to the competent provincial online lending rectification office, which then conducts ultimate verification procedures. Based on the results of the compliance inspections, online lending information intermediary systems that are in compliance with the applicable rules and regulations are authorised to be integrated into industry-wide information disclosure systems and product registration systems. Upon completion of such integration, integrated online lending information intermediaries are able to then submit filing applications pursuant to detailed standards and procedures for record-filings. However, it remains unclear at this time when the detailed standards and procedures for such system integrations and filing applications will finally be issued.

To our knowledge, a number of online lending platform operators submitted their self-inspection reports pursuant to the Inspection Notice and the Self-Discipline and Inspection Circular and are in the process of completing subsequent inspections. It is foreseeable that these strengthened compliance requirements, and greater record-filing requirements in particular, will force smaller online lending platforms to quit the market, while those who successfully land their IPOs and survive will achieve even more market share. In 2018 alone, we have seen over 1,000 online lending platforms cease operations, either due to credit crises or because of allegations of fraud and other scandals. It is estimated that fewer than 500 platforms have continued to exist under normal operating conditions so far, and even less than half of the surviving platforms may eventually manage to complete their record-filing obligations. At the end of the day, the market may see only a limited number of successful market survivors compared to the vast number of historic and current participants, indicating market maturity.

3. Prospects of Private Intelligent Advisors for Foreign Investors

Apart from the highly regulated financial advisory services related to publicly traded funds and securities (which are subject to onerous licensing requirements), certain "intelligent advisers" in the private investment sector (*e.g.*, asset managers exclusively providing services to qualified investors) are subject to a different set of comparatively lax regulatory requirements and have also been subject to increased regulations which will impact China's FinTech sector throughout 2019. As the latest general guideline for the asset management industry, the *Guiding Opinions for Regulating Asset Management Business of Financial Institutions* (jointly promulgated

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by the PBOC, the CBIRC, the CSRC and SAFE on 28 April 2018) further reiterates that any institution which wishes to utilize artificial intelligence technologies to engage in investment advisory services must obtain an investment advisor licence. Non-financial institutions are prohibited from engaging in asset management activities under the alternative name of “intelligent investment advisers” if their registered business scope does not include “asset management”.

Because China has increasingly been opening up its asset management market (including its market of securities investment fund managers) and allowed seasoned foreign investment management firms such as JP Morgan, Black Rock and Fidelity to set up wholly foreign-owned private fund management services in China, it is foreseeable that these foreign giants could be able to further tap into the Chinese private intelligent advisory services market by targeting qualified investors in China.

**IV. Conclusion & Overall Trends**

Taken as a whole, there are many rapidly changing regulatory developments that will shape China’s FinTech sector, both throughout 2019 and into the future. The vast proliferation of recent regulations aimed at formalising many aspects of China’s FinTech industry are bound to create new winners and losers, bringing both new operational hurdles and potential opportunities. While the focus of many commentators on a regulatory “crackdown” on China’s FinTech industry is not without merit, such a characterisation runs the risk of overlooking potential areas of liberalisation within China’s wider FinTech space, especially for foreign participants that have long been restricted from entering this dynamic and innovative arena of China’s economy. Furthermore, although many uncertainties will continue to mark the industry throughout 2019, stakeholders in China’s FinTech industry will need to rely on effective and truly informed local counsel to ensure that they stay abreast of the latest regulatory developments and compliance requirements, and strategically take advantage of new opportunities as they arise in this industry.