Study on Improvement of Fintech Supervision Coordination Rules

Youfang Jin

Zhejiang Sci-Tech University

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Abstract: Innovativeness, complexity and high-tech attributes of financial technology (FinTech) have undoubtedly and significantly increased the complexity of the financial system and the difficulty of financial risk prevention. This has not only posed a huge challenge to the traditional financial supervision, but also set different fields thinking about the adaptability of the traditional financial supervision system and mechanism. Currently, to strengthen the FinTech supervision via a radical reform of the financial supervision system is unrealistic. At the core of efforts to improve the FinTech supervision system is to transform the FinTech supervision functions and modes, clarify the supervision relationship between the central government and the local governments, and build a multi-party FinTech co-supervision system. This paper starts with analyzing the current status of FinTech supervision rules and challenges facing FinTech supervision. Then, the practical situations of FinTech supervision are combined to propose suggestions for improvement of FinTech supervision coordination rules at an attempt to guarantee the rule of law for the in-depth integration between finance and technology.

1. Development status and challenges of FinTech

FinTech, though having improved the efficiency of financial resource allocation, has been found with a series of risks, and these risks are characterized by elusiveness, emergency, infectiousness and negative externality. Financial risks, combined with technological risks, have accelerated the spread of risks to exert an impact on a wide range of industries and markets, and produced cross-industrial, cross-market, and intersection financial risks. Generally, the complexity of FinTech and its risks, compared with the traditional finance, are mainly reflected in the following three aspects:

First, diversification of FinTech participants. By lowering the threshold, such as professional knowledge and infrastructures, required to participate in the financial field, FinTech has turned financial popularization into an increasingly obvious trend. In traditional finance, one cannot have access to financial services unless via financial institutions; currently, however, these financial services can be provided by FinTech companies or other none-financial institutions or individuals. Nowadays, FinTech has been promoted by technology companies and other non-financial institutions. Meanwhile, in a majority of licensed financial institutions, FinTech-oriented transformation and upgrade has been spearheaded by IT departments. All this suffices to show the lowering of the threshold to enter the financial market, and diversification of FinTech participants.

Second, extension of FinTech transaction chains. With the development of the financial technology, a large number of businesses have been transacted online, thus leading to extension of transaction chains, increasing complexity of connection models among trading parties, and growing information interaction with external cooperation institutions. Under the background of FinTech, cross-industry and cross-market financial services have been interconnected, which has contributed to the complexity of financial risks. Business outsourcing of FinTech can bring risks into the financial field from the outside to trigger new problems, such as risks of frauds and information leakage, which will also affect the steady development of the FinTech industries.

Third, diversification of FinTech business models. FinTech has brought about fundamental changes to the financial trading modes, financial product design logic and financial market operation mechanism.. Information financial institutions, technology companies and other players from the non-licensed financial industry have made great strides through in-depth integration with technologies notably modern information technology and artificial intelligence. Ensuing the integration, new industrial forms, new products and new models of FinTech have been popping up. Additionally, new economic forms featuring labor specialization have appeared. Moreover, traditional financial institutions have constantly made use of FinTech to change their organizational structures and operation models, launching new services that are beyond the scope of their industry, such as the supply chain finance, digitalized warehouse warrant, internal big data risk management and pre-warning platforms.

2. Current supervisory rules of FinTech

Currently, FinTech has embarked on the turning point of standard development from the previous irregular growth period. Correspondingly, the FinTech supervision supervisions have been ushered into the transition period of system innovation and rule construction. On the one hand, due to the reliance on the system path and the backwardness of law, traditional supervision rules are still applicable to the supervision of FinTech at the current stage, the former of which attempts to include the latter into the framework of the existing supervision system and monitoring system. On the other hand, as the knowledge of FinTech deepens, and all kind of problems pop up in the process of regulating FinTech with the traditional financial regulatory rules, new rules that are different from the traditional FinTech supervision have been gradually put in place.

At present, to rely on the traditional rules and practices alone cannot satisfy new demands of FinTech supervision. Considering new industrial forms constantly emerging in the FinTech field, the traditional separated supervision model has been found with supervision rules. With the cross-market, cross-industrial, and cross-regional characteristics of FinTech becoming increasingly prominent, mixed operation has become an irresistible development trend of FinTech. According to the traditional separated supervision model, financial business of the same type in different financial institutions might be governed by different supervisory rules, which will easily give rise to regulatory arbitrage. For the time being, China has not yet established an authoritative and efficient financial supervision and coordination mechanism. Thus, problems existing in the assignment of responsibilities and cooperative relationships between financial supervisory departments at the local and central level are calling for immediate solution.

3. Limitations of current supervisory rules

There is still a long way to go for the formation and improvement of FinTech supervisory rules. As legal expressions of the supervisory system, the FinTech supervisory rules have not yet been put in place. In China, traditional supervisory rules still dominate in supervising FinTech. On the one hand, FinTech with its technological elements has improved the allocation equipment of financial capitals, strengthened the risk management capacity of the financial industry, and lowered the concentration of risks. On the other hand, FinTech introduces technological factors under the prerequisite of not changing the vulnerability and risk attributes of the financial industry. Due to these technological factors, financial participants and businesses have been increasingly diversified and correlated, and financial risks have been interwoven to be more complex and hidden. All in all, FinTech has brought about unprecedented challenges to the traditional financial supervision.

3.1 Challenge posed by innovation of FinTech to backward supervision

Along with the acceleration of FinTech market innovation, traditional FinTech supervision has too many problems to deal with in terms of legislation design, institutional construction and operation mechanism, meaning that more legal systems should be introduced. The traditional financial supervisory system and various supervisory rules are outcomes of the previous financial crises, which are formulated against the occurrence of previous risks. As a passive response to previous risks, these supervisory rules are drawn up to avoid the risks occurring previously, which lack a forward-looking reflection on the future. Current normative documents that are related to new industrial forms of FinTech are obviously contingent, and are not targeted at long-term institutional construction. Many normative documents have adjusted FinTech to make it compatible with the traditional supervisory model, or specify FinTech into the list to be outlawed. The boundary of legitimacy of FinTech still remains blurred. Problems, such as inefficiency of supervision and frequent occurrence of supervision loopholes.

3.2 Challenge posed by complexity of FinTech to the commanding-style static supervision

Take a look at China's contemporary financial supervisory models, and one can find that the one-way commanding-style static supervisory model, which is inconsistent with the requirements for the sound development of FinTech, thus incapable of addressing problems, such as risk generalization brought by FinTech, and endogenous and exogenous risks of the financial system.

When the supervisory target is the traditional financial participant or financial industrial status which is simple and not changeful, the supervisory model is probably an ideal way of supervision. However, faced with the FinTech innovation which is highly varied and characterized as a "complex adaptability system", the commanding-style supervision cannot play a due regulatory role, which might, on the contrary, be counterproductive. The commanding-style supervisory rules made up of these compulsory requirements and punishments internally require the financial supervisory rules to be one-size-fits-all ", thus they cannot correctly define the connotation and boundary of the economic content in financial transactions, and have failed to adopt differentiated practices, considering the special characteristics of institutions or financial business that are under supervision.

3.3 Challenge posed by high technologies of FinTech to artificial supervision

The development of FinTech relies on the advanced technologies and systems, but errors of systems and technologies might bring tremendous risks to the FinTech industry. The traditional supervisory mode is probably effective in addressing traditional financial risks. But in the face of the development of financial technologies, intelligentization and informationalization of finance, the traditional supervisory mode has been seriously lagging behind the development of the financial industry. Intelligentization of FinTech, though having found applications in monitoring and guarding against financial risks of technology enterprises, will also bring technological risks into the financial field. On the one hand, the latest technological applications, such as artificial intelligence, have some hidden risks, and the immature technologies are in themselves are a huge source of risks. On the other hand, machine learning will make mistakes like humans, and technological applications, such as the big data technology and artificial intelligence, are vulnerable to being targets or even means of network attack. Obviously, the traditional financial supervision cannot yet developed necessary supervisory facilities and knowledge reserve to cope with risks posed by intelligentization of financial technologies.

4. Suggestions for improvement of FinTech coordination and supervision rules

4.1 Changing FinTech supervisory functions and methods

The reform of the financial supervisory system calls for a huge social cost, for which involves the administrative system, legislation, etc. Large-scale system reform cannot be accomplished in an action to satisfy the need of market supervision. If the reform is too fast, the system operation might lack coordination, and the supervision might exist in form only. In recent years, FinTech has dealt a heavy blow to the traditional financial supervision system, and the financial market has been crying for a good order. This is mainly caused not by the institutional contradiction but by the "malfunction of the government" in addressing specific problems, including specific supervisory systems, supervisory content and methods, etc. Therefore, FinTech supervision in China requires clarification of the FinTech supervisory subjects and their duties and functions. Through transformation of the FinTech supervisory content and methods, the supervisory efficiency can be improved.

To change the FinTech supervisory content and methods generally depends on the transformation of functions from “institutional supervision” to “functional supervision”, and the transformation of supervisory methods from human resources supervision to technological supervision with the supervision technologies at the core. Specifically, in terms of supervisory functions, the macroscopic and prudential management system construction and functional supervision should be enhanced, and more attention should be paid to behavioral supervision, under the current supervision labor distribution system. On the basis of sticking to the labor distribution of the existing institutions, the functional supervision of different financial supervisory institutions should be reinforced, and the penetrability of the supervisory measures should be improved. The People’s Bank of China should be responsible for macroscopic and prudential supervision; the China Banking and Insurance Regulatory Commission, China Securities Regulatory Commission and local financial supervisory institutions should be responsible for functional supervision and behavioral supervision of specific financial activities. In terms of supervisory methods, the supervision technologies should be agile, highly practical, scalable and quick to respond so as to make up the shortages of traditional supervisory methods, and meet high supervision requirements coming along with the emergence of FinTech. In response to new problems and challenges brought by FinTech, reconstruction of FinTech supervisory methods with supervision technologies at the core is necessary.

4.2 Constructing the FinTech technological supervision mechanism at the central and local level

According to supervisions of the existing financial supervisory system and laws, the financial supervisory power falls under the scope of office power of central institutions, mainly including the right to draw up and explain legal rules, right to provide administrative licensing, right to supervise the financial institutions’ daily operation, and right to take statutory and compulsory behaviors. In order to better cope with financial risks at the local level, particularly the issue of financial risk generalization under the background of FinTech innovation, to delegate the right of financial supervision from central institutions to local governments has become an important choice for optimization of the financial supervisory system. Of course, the legitimacy and authoritativeness of the local governments in exercising the right of financial supervision are from the central government, which should be subject to the restrictions of the power hierarchy of local governments and financial supervision authorization of central institutions. Meanwhile, the scope of the power should be limited.

Improvement of the FinTech cooperative supervisory system relies on the dual supervisory coordination mechanism at the central and local level, and from the vertical dimension. The supervisory role of the local government should be emphasized. Through local legislation, the supervisory rights and responsibilities of the local government should be strengthened. The top-down central-local coordination mechanism should be set up by adhering to the system design principle of “central government steering the boat and local government paddling”. At the central level, the State Council Financial Stability Development Commission should be responsible for supervision coordination between the financial supervisory right at the central and local level, and handle the functional contradictions between “People’s Bank of China, China Banking and Insurance Regulatory Commission, and China Securities Regulatory Commission” and the local financial supervisory institution. In coordination of the specific supervisory behaviors, the measures of the central government can be referred to, that is, the provincial branches of the People’s Bank of China functions as the local agency of the State Council Financial Stability Development Commission, spearhead efforts to coordinate the financial supervision right at the local level, and plan and coordinate the financial supervision institutions at the central and local level. As to specific functions, the legal authorization and responsibility positioning of different supervisory institutions are different. In a bid to ensure the supervisory effects, efforts should be redoubled to enhance the supervision coordination among various supervisory institutions. Provincial branches of the People’s Bank of China should be responsible for supervision coordination; the China Banking and

Insurance Regulatory Commission and its agencies should be in charge of supervising the licensed financial institutions in the banking and insurance industry; the China Securities Regulatory Commission should be in a position to supervise licensed financial institutions in the securities industry; the local financial supervision departments should be responsible for supervising the “7+4” institutions, and financial institutions which are informal or non-licensed. Of course, different institutions have different focuses in terms of their supervisory content. The People’s Bank of China emphasizes on prudential supervision; while the China Banking and Insurance Regulatory Commission, China Securities Regulatory Commission and financial supervision institutions at the local level are mainly responsible for behavioral supervision.

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[6] The supervisor first draws up a detailed set of code of conduct, and then requires the supervision targets to abide by these rules. When the supervision targets go against supervision rules, the supervisor will issue the supervisory instructions as a punishment.

[7] See Lawrence G.Baxter, Adaptive Financial Regulation and Regtech: A Concept Article on Realistic Protection for Victims of Bank Failures,66 Duke Law Journal 573,2016.

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