

A Brief Analysis of International Exploration and Domestic Pilot of Fintech Regulatory Innovation

RunNan Tu, Zhang HUA

Peking University, Beijing, China
plato_c@sina.com

ABSTRACT. FinTech is a complicated system engineering, which demands higher requirements for the professional specialty of financial supervision. In recent years, the financial regulatory authorities in many countries and regions positively explore FinTech regulatory innovation and have obtained certain experience, such as: to give appropriate regulatory exemptions to the pilot enterprises, to clear the entry criteria for the engaged enterprises, to determine the rules of time limit, scope and exit for the pilot test, to strengthen the protection of the financial consumers' rights and interests engaged in the pilot, to establish and perfect information disclosure institution, etc. Through referring to the development experience of foreign countries and avoiding the problems in their exploration, in an orderly and steady manner, our country will implement the pilot of FinTech regulatory innovation from the aspect of the party of supervision and implementation, the party of testing and the financial consumers.

KEYWORDS: Fintech regulatory innovation, Financial supervision, Financial innovation

1. Introduction

In recent years, the FinTech develops fast and deeply influences the business model and ecology of the financial industry. At the same time, it also leads to many risks such as information security and challenges the original financial regulatory model. Under this background, the financial regulatory authorities in many countries and regions are positively exploring FinTech regulatory innovation. In March 2015, the Financial Conduct Authority (FCA) firstly proposed the concept of establishing the “regulatory sandbox”, and then in May 2016 FCA officially activated the “regulatory sandbox” mechanism, which promoted the UK to be the first country to carry out the “regulatory sandbox” of FinTech all over the world^[1]. At present, Australia, Singapore, the United States, Hong Kong, Malaysia and some other countries and regions have implemented the “regulatory sandbox” mechanism in succession^[2]. That how to promote financial regulatory to adapt to the new normality of financial technology and to improve the quality and efficiency of financial regulation has become a major subject in the field of finance.

2. Exploration Experience of Foreign Regulatory Innovation

In recent years, FinTech regulatory innovation models, such as regulatory sandbox, have been gradually approved and promoted by more and more financial regulatory authorities in different countries and regions^[3]. Their practices are mainly as follows:

2.1 Moderate Regulatory Exemptions

Although the ways are different, various countries and regions mainly grant certain exemptions to the applicants in terms of registered capital, law application, etc., to ensure that the applicants are exempt from the constraints of current regulatory rules. For example, the FCA issues a “Non-enforcement Commitment letter” for a licensed financial institution under the background that the innovative scheme does not clearly violate the FCA regulations; As far as the non-licensed financial institutions are concerned, FCA will issue restricted financial license under the condition of testing innovative products or services within prescribed conditions and periods. The Financial Services Authority of Singapore (MAS) stipulates that financial technology companies registered in the sandbox are permitted to engage in businesses that partially conflicts with regulations if they implement the process of report in advance. Financial Service Authority in ABU Dhabi's proposed a “blank sheet” regulatory law. It regulates that the financial institutions authorized will not be subject to the existing regulations when they operates their activities in a “regulatory laboratory”.

2.2 Clear the Entry Criteria

The financial regulatory institutions with regulatory sandbox in different countries and regions have set detailed entry criteria and based on these criteria they have made a decision that whether the applicant can apply the regulatory sandbox or not. For example, FCA clears the following four standards: relevant activities must be regulated by FCA or be carried out by the enterprises and institutions regulated by FCA; The products or services which apply for sandbox testing must be original or significantly different; Testing products or services should have the potential to provide financial consumers with higher quality services or favorable prices; The product or service to be tested has been pre-tested.

2.3 Determine the Time Limit, Scope and Exit Items for the Testing in Advance

Most countries and regions have made specified regulations of the time and scope for financial institutions or FinTech enterprises to participate in regulatory sandbox testing. For example, FCA stipulates that testing time of the sandbox shall not exceed 6 months in principle; The number of customers who are participating is moderate, both to meet the requirement of obtaining relevant statistical data, but also to strictly control the scale of the test. The MAS regulates that the applicant must withdraw from the sandbox after the expiry date of the sandbox testing time; Applicants who want to extend the testing period should apply at least one month before the date of expiration of the sandbox.

2.4 Strengthen the Protection of the Rights and Interests of Financial Consumers

When foreign financial regulatory institution, such as FCA, implemented sandbox plans, it proposed to formulate relevant protection measures so as to maintain the rights and interests of financial consumers. The FCA proposed as follows: firstly, it should notify the financial consumers the potential risks and alternative compensation in details for participating in the test; Secondly, the financial consumers participating in the test own the same legal rights and interests just like the ordinary financial consumers; Thirdly, the companies or institutions participating in the sandbox testing should possess sufficient financial resources to undertake the payment or compensation of the financial consumers.

2.5 Establish and Perfect the Information Disclosure System

The FCA specifies that the testing enterprises and institutions must publish the information of testing periods, testing procedures and compensation arrangements before they participate in regulatory sandbox testing; During the testing period, the testing enterprises and institutions shall report the progress of the major work, major findings in the test and proposals for improving risk management to the regulatory authorities on schedule; After the testing, the testing enterprises and institutions shall submit a complete written report to comprehensively summarize all aspects of the test.

3. Problems in Regulatory Innovation

3.1 The Aspect of the Party of Supervision and Implementation

Firstly, it is trapped in regulatory authority. Because most of the testing organizations are FinTech newly-established firms which are difficult to be assessed, the regulatory implementation parties require the enterprises to meet with the relevant conditions before they participate in the sandbox test and then they will be authorized to conduct the test. As a result, although the regulatory sandbox has fulfilled some deregulation in the testing process, it is difficult for some newly-established technology enterprises to get regulatory authorization indeed from the origin. Secondly, there are different standards of exit mechanism. In different countries, the withdrawal mechanism of regulatory sandbox lacks uniform standards, and the party of regulatory implementation faces the loose regulation problems of the withdrawal mechanism.

3.2 The Aspect of the Party of Testing

Firstly, there are barriers to entry. It is difficult to acquire banking services. Because of the higher risk of newly-established technology enterprises and the risk of money laundering and terrorist financing, it is difficult for them to promote their risk tolerance and balance sheet assessments to meet bank account requirements. As a result, test subjects face the problem of difficult access to banking services. Secondly, there are process barriers and long testing

period. The subject of supervision and implementation takes a cautious attitude towards the examination of sandbox objects, and formulates relatively strict access conditions, which leads to the lack of flexibility of the testing subject. Sandbox test participants are usually financial technology newly-established enterprises, if the period of audit is too long, it will not only cause more cost of time, but also may miss the best opportunity for the innovative products to enter the market.

3.3 The Aspect of the Financial Consumers

Firstly, there is discrimination of consumption preferences. It is proved that consumers have a higher demand of innovative products and services in practice. However, consumers are liable to choose large companies or established financial institutions with power and credit. As far as those small newly-established enterprises without a good reputation are concerned, it is a troublesome problem to attract and obtain customers. Secondly, there are technical barriers of the consumer information feedback. The testing participants obtain and analyze the consumers' transaction information with the help of regulatory sandbox so as to provide products and services that meet consumers' demand.

4. Suggestions on Carrying out Pilot of the Fintech Regulatory Innovation in China^[4]

On March 16, 2020, the first batch of six innovation supervision projects began to be piloted. On April 27, the People's Bank of China (PBOC) issued a statement that it was to support the expansion of pilot projects in six cities (districts). From the situation of the pilot in Beijing, the pilot project goes well, but there are still some defaults, such as regulatory guidance is still not implemented, relevant supporting mechanism needs to be perfect, etc. In order to meet the actual need in China better, some suggestions on carrying out pilot of the FinTech regulatory innovation in China would be brought up cautiously.

4.1 The Aspect of the Party of Supervision and Implementation

Firstly, it is to clarify the responsibilities of each regulatory department. Although the innovation supervision pilot makes the test relatively focus on a certain region, the financial products or services entering the test have the characteristics of cross-regional, cross-industry and cross-market, the test cannot be led by the local regulatory authorities. Instead, a unified regulatory implementation body should be established to stimulate regional synergies. Secondly, it is to build a trans-regional cooperation mechanism on the basis of seeking common ground while reserving differences. China's mainland financial regulatory science and technology innovation can regularly communicate with regulatory institutions in Hong Kong and other regions to establish the communicating office, so as to share the situation of supervision of the test cases and simplified process on schedule. Thirdly, it is to give appropriate regulatory exempt. It is suggested to draw lessons from international experience to revise the current relevant regulatory policies in appropriate time, and clarify the conditions and procedures of regulatory exemption^[5]. Financial regulatory authorities are allowed to grant certain regulatory exemptions to test projects within their own limits of competence, so as to improve the risk of tolerance of innovative businesses. Fourthly, it is to establish and improve the mechanism of evaluation. Currently, they can choose some projects with a certain number of participating consumers or customer groups and carry out the evaluation from the aspects of privacy protection to evaluate whether it will affect financial stability or not and whether it will lead to personal privacy leakage and other risks^[6].

4.2 The Aspect of the Party of Testing

Firstly, it is to begin from the licensed financial institutions and then gradually promote the implementation, narrow the scope of applied subjects for testing, comprehensively consider the risks they will face, gradually encourage companies to cooperate with licensed financial institutions, and fully give play to the advantages of licensed financial institutions in terms of qualification examination and risk control so as to widen the scope of business testing. Secondly, it is to introduce companies to create synergies. It is to allow companies working with licensed financial institutions to conduct tests. Thirdly, it is to encourage test companies to establish partnerships, which can not only help new-established enterprises to gain the superior resources and experience from large companies and attract target customers to participate in testing, but also promote large companies to innovate and improve products more efficiently and reduce R&D procedures to reduce costs.

4.3 The Aspect of the Financial Consumers

Firstly, it is to pay attention to the protection of the consumer information, build consumer data sharing platform.

Facing the technical barriers in the testing process, the government can set up a data sharing platform between the newly-established enterprises and banks in order to cooperate in the research and development of technology. Secondly, it is to pay attention to the protection of the rights and interests of financial consumers^[7]. The innovation supervision pilot should set up strict access principles and comprehensive exit mechanism to protect consumers' rights to know and free choice. Before the test, it is necessary to notify the consumers the risks they may face and then to make sure that they engage in voluntarily rather than through binding or coercion.

References

- [1] FCA. Regulatory Sandbox [R/OL]. 2015 [2020.6]. <https://www.fca.org.uk/publication/research/regulatory-sandbox.pdf>
- [2] Lee, I, & Shin, Y. J. (2018). Fintech: ecosystem, business models, investment decisions, and challenges. *Business Horizons*, 61.
- [3] Arner, D, Barberis, J., & Buckley, R. Fintech, regtech and the reconceptualization of financial regulation. Social ence Electronic Publishing, 2016
- [4] Arner, D., Barberis, J., & Buckley, R. (2016). Fintech, regtech and the reconceptualization of financial regulation. Social ence Electronic Publishing.
- [5] Xiaodan Wang. (0). The Innovation Model of Risk Control of Fintech and Regulatory Sandbox.
- [6] Zhi-Yun, L., Sheng, L., Law, S. O., & University, X. (2019). The innovation of legal regulation of fintech: development analysis and localization thinking of the regulatory sandbox. *Journal of Xiamen University (Arts & Social Sciences)*.
- [7] Weiliang, X, & Wende, X. Comparative study and analysis of "regulatory sandbox": latest development、practical experience and enlightenment. *west china finance*, No.10, pp.18-24+36, 2017.

作者简介

中文简介

姓名：图闰男 性别：男 出生年月：1987.6 籍贯：北京 学历：研究生 职称：
经济师 单位：北京大学
研究方向：金融工程 所在省市：北京 邮编：100871
邮寄地址：北京西城区爱民街2号院 电话：17301083759
邮箱：plato_c@sina.com

姓名：华章 性别：男 出生年月：1965.10 籍贯：北京 学历：研究生
职称：副教授 单位：北京大学
研究方向：金融工程 所在省市：北京 邮编：100871

English Introduction:

Name:Run-Nan Tu Gender: male Date of birth: 1965.10 Native
place:Beijing Education: graduate student Title:economist
Company:Peking University research direction : financial engineering
City:Beijing
Zip code:100871 Mailing address : Courtyard 2, Aimin street, Xicheng District, Beijing
Tel:17301083759
Mailbox:plato_c@sina.com

Name:Zhang Hua Gender: male Date of birth: 1965.10 Native
place:Beijing Education: graduate student Title:associate professor
Company:Peking University research direction : financial engineering
City:Beijing
Zip code:100871