

TO REGULATE OR NOT TO REGULATE?

A comparison of government responses to peer-to-peer lending among the United States, China, and Taiwan

CIBEL Global Network Conference
UNSW Sydney, 1 May 2019

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Introduction

- ▶ Peer-to Peer (P2P) lending business models as well as government responses to those models differ.
 - ▶ The United States: **reactive**, requiring platforms to comply with extant **securities regulation**
 - ▶ China: initially **hands-off**, turning **reactive**, limiting P2Ps to the **information intermediation** model due to a series of P2P failures.
- ▶ Taiwan's regulatory response to P2P lending, led by its Financial Supervisory Commission ("FSC"), the sole financial market watchdog in Taiwan, started as **reactive**, warning that the P2P lending industry should not cross four major red lines drawn under existing regulatory and business structures.
 - ▶ Taiwanese government turns **more proactive**—at least **in form**, introducing the "FinTech Sandbox Act" in 2018, permitting cautious regulatory experimentation.
 - ▶ Mission Conflict: this Act may, **in substance**, be an ineffective means to address the regulatory dilemma between prudential regulation and financial competition and innovation.
 - ▶ The Proposal: a structural change in the current institutional design that could reallocate the authority of financial competition and innovation to a more motivated financial agency, separate from and independent of the FSC

P2P Lending in the United States

- Prosper and Lending Club enjoy 98% of the U.S. market share.
- The P2P lending industry's success can be attributed to timing.
 - After the GFC in 2008, the increase in political scrutiny— alongside the fact that interest rates continued to remain low—created an opportunity for P2P lenders to project themselves as an accessible alternative for borrowers.
- Instead of being an **information intermediary** between lenders and borrowers or selling loans to investors wholesale (debt assignment model), a number of transactions can be categorized under the **asset securitization** model.
- After the SEC started to regulate P2P lending platforms via the extant **securities regulation**, U.S. P2P platforms were required to sell the notes by prospectus and file annual and quarterly reports.
 - With increased scrutiny by the SEC, P2P platforms increased their minimum required credit scores, which were substantially higher than domestic microfinance institutions require.
 - The SEC's effort to regulate the industry created barriers to entry for economically marginal and geographically isolated borrowers.
- The P2P lending regulation in the US is a subdivision of securities regulation under which P2P lending platforms are treated as issuers by the SEC.

P2P Lending in China

- The rise of P2P lending industry in China illustrates a market-oriented response to (1) limited opportunities open to smaller businesses for obtaining financial services from banks and to (2) low returns offered to savers or investors.
- We can categorize P2P lending in China into the following four major business models.
 - The Information Intermediation Model (For example, Paipaidai ())
 - The Guarantee Model (Hongling Capital ()), for example)
 - The Asset Securitization Model (e.g., Lufax (), incubated by Pingan Insurance Group)
 - The Debt Assignment Model (e.g., CreditEase or Yixin ())
- Following several years of rapid growth in internet finance, the Chinese government gave up its previous **hands-off** approach to monitoring online financial products or services and turned **reactive**, after the outbreak of scandals, fraud, and high-profile P2P failures.
 - In July 2015, the Chinese government introduced its first major guidance policy on internet finance.
 - Existing Chinese regulations constitute a **“One + Three” regulatory system** for P2P lending.
 - The information intermediation model becomes the only one that meets the aforementioned requirements, outlawing the debt assignment, asset securitization, and guarantee models, mentioned above.

P2P Lending in Taiwan

- Taiwan's P2P platforms remain on the sidelines or underground, fearing the potential violations of laws and regulations and the following legal enforcement.
 - With concerns about current circumstances of over-banking, the FSC hesitated to decide whether to formally authorize the P2P lending industry in Taiwan.
 - SMEs may address their financing demands via alternative financing channels, e.g., P2P lending.
- Due to the lack of customized regulations applicable to P2P lending, the FSC could only
 - require those platforms to play a role of **mere information intermediaries** matching borrowers & lenders
 - closely monitor those platforms to determine whether they cross **four red lines** drawn under the Security and Exchange Act ("SEA"), the Banking Act, the Act Governing Electronic Payment Institutions (the "EPI Act"), and the Financial Asset Securitization Act (the "FASA").
 - The FSC in 2016 warned that matching business conducted on P2P platforms could not involve "publicly issuing securities" under SEA and "publicly issuing Beneficial Securities or ABS under the FASA.
- Whether requiring P2P platforms to register with the FSC in their infancy under the SEA or FASA, or requiring those platforms to apply for a bank/Electronic Payment Institution license may increase the cost to newly-established P2P platforms, hindering the concomitant financial innovation and inclusion.

A Comparison of Regulatory Responses to P2P Lending

- When it comes to regulatory responses to Fintech startups, scholars examining the likelihood of promoting much structural change distinguish between two broad categories of change—“**reactive**” and “**proactive**”
- **U.S.** government's response: the SEC regulated P2P lending platforms in line with the **extant** securities laws, reflecting that the SEC's response to P2P lending was **reactive**.
- **Chinese** regulatory response: Chinese government **initially adopted a hands-off approach**, but shifted toward a **more reactive** approach after many P2P failures, stressing P2P platforms can only adopt **information intermediation model**.
- **Taiwanese** government response: it **initially** seems to be **reactive** in warning the P2P lending industry **against crossing four major red lines**, while highly encouraging the P2P industry to collaborate with banks.
 - Taiwan took a **more proactive** approach to FinTech in January 2018, creating a formal regulatory sandbox regime by enacting the “FinTech Sandbox Act”.
- I argue that Taiwan's legislation of the regulatory sandbox **cannot be proactive only in form**.
 - **In substance**, as a **short-term** goal in the reform agenda, a **more principles-based** strategy of financial regulation (or “**MPBR**”) is a key point, as is the regulatory attitude.
 - As a **long-term** goal toward a structural change in the extant regulation of incumbents, I propose reallocating competition authority to a motivated financial agency, that would be separate from and independent of the FSC.

More Principle-based Financial Regulation (“MPBR”)-embedded Regulatory Sandbox?

- As a short-term goal in the reform agenda, MPBR is a key point.
 - To establish **a flexible and proportionate regulatory regime** where regulators and the regulated **collaborate, carry on a dialogue, and experiment** with what would be more appropriate regulatory approaches. **(MPBR)**
 - Regulators of FinTech firms across an increasing number of jurisdictions including Taiwan have shifted to a **more formal and structured regulatory experimentation**, i.e., regulatory sandboxes.
 - **The FinTech Sandbox Act** was, in early 2018, formally passed in Taiwan.
- **Theoretically**, Taiwan’s legislature would, via these provisions (Articles 17 and 18), embed MPBR in FSC’s mindset.
 - In this environment of MPBR, regulators, traditional service providers, and FinTech innovators can carry on an **ongoing, sophisticated, and iterative regulatory dialogue** regarding effective experiments to gather relevant information and to identify an appropriate regulatory model.
- Some might wonder: **in practice**, could the Taiwanese regulatory sandbox effectively prevent such FinTech industry, like P2P lending, from excessive exposure to legal risks, since Articles 17 and 18 of the FinTech Sandbox Act appear to have established an MPBR regime of (where regulators and the regulated can collaborate, carry on a dialogue, and experiment with what would be more appropriate regulatory approaches)?

The Political Economy of Regulating P2P Lending and Its Implications for FinTech Regulation in Taiwan

- The FSC issued an appendix titled “FinTech Sandbox FAQ”, to implement the FinTech Sandbox Act in April 2018
 - The FinTech Sandbox FAQ excluded P2P lending platforms from application to the FSC for innovative experiments.
- Why did the FSC give this unwelcome informal guidance for the P2P lending?
 - Traced back to 2016, when the FSC had initially taken a **reactive** approach in 2016, suggesting that P2P platforms should **merely act as an information intermediary**.
 - Taiwan appears to have shifted to a **more proactive** response to FinTech by legislating the FinTech Sandbox Act.
 - This shift is arguably **just in form**—the FSC, **in substance**, may be more committed to the existing style of regulation, lacking incentives to abandon the current approach in favor of the newly mandated alternative approach.
 - FSC potentially subject to regulatory capture, inertia, and the tendency to be averse to risk.
 - Even a more structured change in the current financial regulation such as the FinTech Sandbox Act might also be troubled by the FSC’s **conservative implementation**, although the legislature would like to be more, truly proactive
- From an institutional design perspective, proposing reallocating competition authority to a motivated financial agency to provide **long-term** regulatory certainty for FinTech-driven financial market development by stimulating financial competition and innovation.

Conclusion

- **The United States:** **Reactively** regulated P2P lending start-ups under its extant securities regulations, setting forth regulation that may be intentionally strict so as to contain industrial development.
- **China:** After a slew of major P2P scandals, including outright criminal violations, the **Chinese** government abandoned the **initial hands-off** regulatory approach and became **reactive** as well, by requiring business models of Chinese P2P lending to be **limited to the information intermediation**.
- **Taiwan:** When it comes to government responses to P2P lending in **Taiwan**, the FSC had been **reactive** by highly encouraging collaboration between P2P platforms and banks, actually implying that the platforms need to comply with laws and regulations applied to banks.
 - The Taiwanese government appeared to become **more proactive** when it enacted the statute to implement the regulatory sandbox, **the FinTech Sandbox Act**, in 2018.
 - Such a **proactive** shift in response to FinTech may have been **proactive in form** alone, as the legislative sandbox may not be an effective means to address **regulatory dilemmas (mission conflict) between prudential regulation and financial competition and innovation**.
- In order to refrain from forcing FinTech startups to exit from Taiwan and relocate overseas due to long-term regulatory uncertainty, we could preliminarily consider a holistic reform agenda, i.e., adopting a fully independent consumer financial competition watchdog.

Q & A

Thank You!