ISSN 2616-5902 Vol. 4, Issue 15: 70-74, DOI: 10.25236/AJBM.2022.041512

Research on Financial Supervision Issues Related to the Ant Financial Event

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Abstract: *With the rapid economic development and the continuous upgrading of financial innovation, there are many Internet companies in science and technology related to online loans. At the same time, many technology companies have also launched online loan businesses and even created a wide variety of loan products. As a focus of Internet financial enterprises, Ant Financial relies on payment business and scenario development to conduct comprehensive customer insights. It jointly lends with banks and financial institutions, forming a new type of microcredit on the Internet. Internet microcredit has played a positive role in liberalizing interest rates and developing finance. But it still carries various risks, such as credit risk and high leverage risk. The suspension of Ant Financial's listing has deeply affected the hearts of government regulators, the Internet finance industry, and related researchers and may profoundly change China's Internet finance. The Internet finance supervision issues involved are worth pondering. Taking Ant Financial as an example, this article analyzes the problems existing in the supervision of financial technology companies and makes reflections and suggestions.*

Keywords: *Ant Financial; Financial regulation; Online lending; Financial technology*

1. Introduction

Ant Financial's microcredit on the Internet business developed from the "Credit Link Index" founded by Ali in 2002 and has now completed the accumulation of original merchant data, thus laying the foundation for the development of Sesame Credit and Taobao Credit. In order to solve the financing difficulties of e-commerce sellers, Ali cooperated with banks and launched "e-daitong" and "easy financing" products for small loans. Later, Zhejiang Alibaba Small Loan Co., Ltd. and Chongqing Alibaba Small Loan Co., Ltd. were established, and digital circulation unsecured consumer credit products such as Ant Credit Pay and AntLoan were launched to lend by themselves. After 2016, Ant's micro-loan business expanded rapidly and became the main source of income. Ant Financial has carried out multiple rounds of asset securitization for large-scale financing due to its relatively stable cash flow that can be expected. In November 2020, four departments were interviewed and put forward five rectification requirements to maintain the order of the financial market and prevent the disorderly expansion of capital before Ant Financial's listing.

This incident has closely affected government regulators, the Internet finance industry, and related researchers and has also widely influenced the themes of online public opinion. In addition, it is likely to change China's Internet finance trend. The Internet financial supervision issues involved are worth pondering.

2. Ant Financial's Methods and Means of Making Profits

2.1 Close to the Red Line - the Resort to High-Interest Rates

Take the college student's purchase of Taobao's 2020 new Apple 10.9-inch iPad as an example; the loan amount is 4699 yuan. The principal and interest are paid in 12 installments (including handling fees) using Ant Credit Pay, and each installment is 420.95 yuan. The fixed principal repaid every month is 4699/12=391.58 (yuan). So the monthly interest payment is 420.95-391.58=29.37 (yuan). We believe that by paying a small monthly interest, we can get the goods we need, but we unconsciously fall into the Ant Credit Pay installment trap. Each time the principal is repaid, the principal owed will be less and less. If calculated according to a fixed ratio, the interest paid by college students should be less each time, but they pay the same interest each time and are burdened with higher annual interest rates. The internal rate of return calculator (Whale Calculator mobile APP) shows that the actual annual interest rate is 14.44%, nearly double the 7.50%.

On January 31, 2002, the People's Bank of China issued the "Notice of the People's Bank of China on Banning Underground Banks and Combating Usurious Lending", which was issued and implemented on the same day. However, the interest rate negotiated by the two parties shall not exceed four times the financial institution's loan interest rate (excluding floating) for the same period and the same grade announced by the People's Bank of China. If the above standard is exceeded, it should be defined as high-interest lending." Calculated at four times the one-year loan market quoted interest rate of 3.85% released on July 20, 2020, the upper limit of judicial protection for private lending interest rates is 15.4%. Although Ant Financial has not violated the regulations, its interest rate is close to this red line [1].

2.2 Mortgage Loan with Creditor's rights

The main body of Ant Financial is Alipay, and Alipay has a large number of merchants and customers. When merchants and customers use Ant Credit Pay and AntLoan, a loan relationship occurs between the two. At the same time, a loan contract was created. Ant Financial packaged contracts with different credit risks and placed them in SPV institutions. Then, they stratified contracts with different credit risks and divided them into three levels: excellent, good, and poor. At the same time, rating agencies were asked to evaluate the grades of bonds at different levels, the so-called ABS (asset-backed securities). Afterward, the rated bonds are divided into several shares and sold to asset management institutions through the market. The received selling price is deposited into the SPV institution, and the SPV institution returns the received money to Ant Financial. Ant Financial lends money to the next batch of merchants and customers. Finally, Ant Financial pays part of the principal and interest paid by merchants and users to asset management institutions (investors).

Suppose a bond investor buys a 4.44% fixed-income wealth management product. Ant Financial acts as an intermediary because not only can the principal be quickly recovered by selling the bond, but also the interest can continue to be charged. As mentioned above, Ant Credit Pay's interest rate is 14.44%, while the interest rate of the bonds it sells is only 4.44%, with a 10% interest rate difference in the middle, which is enough for Ant Financial to make much money. It does not need to lend too much principal to merchants and users. It only needs to sell bonds, and the funds can be taken from asset management institutions and lent to the next batch of merchants and customers [2].

2.3 High Turnover and High Leverage-Improved Capital Utilisation

Ant Financial first loaned more than 6 billion yuan from banks with a capital of more than 3 billion yuan and a loan ratio of 2:1, so Ant Financial had more than 9 billion yuan of capital and then carried out capital lending and its securities capital. The CSRC does not stipulate how many times ABS loan assets can be recycled. When a loan balance gets ABS bonds issued by the stock market exchange, it can be recycled to issue loans. Ant Financial took advantage of loopholes and gradually formed a mode of "loan-lending-capitalization of securities ABS-collection of money-lending." If it is the lending process of a traditional financial company, the ABS cycle will take a year. However, Ant Financial, with the help of efficient and convenient Internet platform technology, has released billions of loans in three days. It can be cycled ten times a year, 40 times in only four years, and more than 3 billion principals have issued more than 360 billion online loans, forming a high leverage of nearly 120 times.

2.4 Spreading Risk-The Absence of Financial Regulation

Ant Financial is a loan company under the jurisdiction of the China Banking Regulatory Commission and the Central Bank. However, asset securitization ABS is under the jurisdiction of the China Securities Regulatory Commission. Under China's separate supervision mechanism, the China Securities Regulatory Commission has no right to manage Ant Financial, and the China Banking Regulatory Commission and the Central Bank have no right to manage Ant Financial's ABS. Because Ant Financial's ABS did not violate the regulations formulated by the China Securities Regulatory Commission, in 2017, the central bank, the China Banking Regulatory Commission, and the China Securities Regulatory Commission decided to rectify the asset management business jointly. Ant Financial's loan stock has declined rapidly, from more than 300 billion online loans to more than 100 billion. The risk of such agglomeration is enormous, and the consequences are serious because the risk pervades society [3].

3. Financial Supervision Problems in the Process

3.1 Deficiencies in the Legal System

With the diversified development of Internet financial services and the increase in the types of financial products, such as online banking, third-party payment platforms, and online loans and other diversified business forms, affected by the network environment, it has improved the evasion of finance to the legal and regulatory system, which has brought great challenges to the previous regulatory policies. Especially in the fastest-growing P2P and online lending fields, supervision is particularly insufficient, and a unified and effective supervision system has not yet been established. On the other hand, due to the certain intensive nature of Internet technology, the development is relatively fast. The system is driven by technology, and there is a certain lag in development, which makes the existing legal system inapplicable to the current Internet financial supervision. For example, big data and cloud computing technologies have not yet established a matching regulatory system, and the existing systems lack specific operability. In addition, even though the Internet Finance Association has been established, the corresponding regulations, industry norms, and other systems are not yet perfect, resulting in a lack of self-discipline in the industry and increasing the difficulty of Internet finance supervision.

3.2 Lack of Perfection of Internet Market Access Mechanism

Due to the short development time of China's Internet industry, there are defects in the market access mechanism. The overall threshold is relatively low, especially in Internet financial wealth management, which has led to many P2P wealth management platforms that do not meet industry standards entering the Internet financial market. For example, the "ezubao" company not only reduces the stability of the Internet financial system but also affects financial consumers' trust in online financial institutions. In severe cases, consumers will be adversely selected, and many online financial platforms have collapsed [4].

3.3 Imperfection of Network Credit System Department

The credit reporting system is an essential means to ensure the stability of the financial market, reduce credit risks, and promote the healthy development of the financial market [5]. However, due to the relatively late start of China's credit information system, it is still in its infancy and has not yet covered many fields. China's credit reporting system has not fully penetrated the Internet financial industry, leading to some financial enterprises' integrity.

4. Recommendations for the Financial Regulatory System

4.1 Improved Financial Risk Control System and Norms

Relevant departments should strengthen the research and analysis of online financial forms under the new situation, find the deficiencies in implementing the management system and improve them [6]. In addition, rationally use legal means to effectively implement online financial market norms to all Internet financial institutions, increase supervision, and ensure that online financial institutions strictly abide by market norms.

4.2 Perfection of Market Access and Withdrawal System

China initially established a market access mechanism, but it is imperfect and can only play a role in some Internet financial enterprises. It requires regulatory authorities to improve the system to play a more significant role in the online financial market [7]. On the one hand, the management department should learn about the current development of China's Internet market, appropriately increase the market access threshold, clarify the access conditions that should be followed, and formulate different access mechanisms for different types of Internet finance. On the other hand, the management department should also change the previous exit mechanism to prevent financial enterprises from withdrawing from the market at will and endangering public interests, which is of great help to ensure the stability of the financial market [9] [10].

4.3 Speeding up the Improvement and Implementation of Financial Market Self-discipline Norms

In recent years, China has established an Internet Finance Professional Committee, which is mainly responsible for guiding and regulating various behaviors in the Internet financial market and has played a specific role. Overall, due to the lack of perfection of the market self-discipline regulation, the role of regulation in online financial supervision has not been fully utilized. In this regard, the Internet Finance Association will improve the self-discipline norms, formulate a matching punishment system, and promptly clarify the industry self-discipline norms and punishment mechanisms for Internet financial institutions regarding business qualifications and fund management [11][12]. Then, a reputation mechanism should be developed, and a mass supervision channel should be established to allow the public to participate in the supervision process and improve the efficiency of supervision and management. In addition, an information system should be established to regularly collect, analyze, count, sort, and evaluate relevant information in the online financial industry to ensure that the industry can maintain healthy competition.

4.4 Establishment of Consumer Rights and Interests Protection Mechanism

When solving Internet financial problems, regulatory authorities should strengthen the protection of online financial consumers, and protect the interests of service objects by improving relevant legal systems, thereby laying a solid foundation for the stability of the financial market. First, in the specific construction, it is necessary to establish a consumer-oriented complaint channel and information acquisition channel to ensure that consumers can understand relevant information and make reasonable complaints [8]. Second, the regulatory authorities should clarify the responsibilities and rights of all parties involved in Internet financial transactions, including protecting personal information and the right to know, to protect consumers' legitimate rights and interests. Third, the introduction of consumer personal information and fund security into the financial market exit mechanism to enhance the effectiveness of consumer rights protection [13].

4.5 Clarify Relevant Legal Liabilities

In establishing an Internet financial supervision system, to ensure that the rights and interests of consumers can be implemented, the responsibilities of both parties in the business should be clarified in the relevant institutional system. And the legal responsibilities and consequences of violations by both parties should be clarified [14].

5. Conclusion

With the development of Internet finance in China, if the regulatory authorities want to ensure the industry's stability, they need to do an excellent job of rethinking the regulation. In this regard, through the case of Ant Financial's emergency suspension of listing, we analyze the Internet financial industry to find out the current regulatory problems in China's financial market. Then we put forward some suggestions and reference measures to improve the Internet financial supervision system.

Fintech is a beneficial thing, and it can be used as a supplement to existing banks. Ant Financial is exploring loan opportunities that are inconvenient or impossible for traditional banks to explore. However, the hidden risks are not borne by Ant Financial itself but by society. The financial crisis of the whole society caused by the wrong decision of one company is not allowed.

The crisis caused by Ant Financial has some similarities with the 2008 financial crisis. On the one hand, the risks of Ant Financial's unsecured credit loans and U.S. property-backed loans are close to risk-free. On the other hand, Ant Financial's available issuance of MBS is similar to the abuse of financial derivatives in the United States, and both underestimate financial risks. After the 2008 financial crisis, the U.S. government stepped up its supervision of financial products, which led to the emergence of Basel III, which imposes strict restrictions on various financial institutions to prevent the recurrence of financial risks. Although the issuance of financial products by Ant Financial can revitalize existing loans and support enterprises, any financial product has risks. If it cannot be controlled, it will cause a crisis. They cannot be separated from the national regulatory system and must be strengthened.

The starting point of financial supervision is to safeguard the interests of the public. Public interests are scattered in various industries, and institutions authorized by national laws can only exercise power to safeguard such interests. There are defects in the market. A completely free market will lead to the loss

ISSN 2616-5902 Vol. 4, Issue 15: 70-74, DOI: 10.25236/AJBM.2022.041512

of natural monopoly and social welfare, and there are also problems of unfairness caused by external effects and information asymmetry. Therefore, to safeguard the public's interests, the state must supervise financial institutions. Relevant departments correct or eliminate market defects through management to improve the efficiency of market social resource allocation and reduce social welfare losses. When the supervision is appropriate, the cost of financial supervision can be minimized while enhancing the overall interests of the public.

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