

# *The Current Situation and Hidden Dangers of Internet Finance in China*

Runzhi Wang<sup>1,a,\*</sup>

<sup>1</sup> Department of Science, University of Bristol, UK  
a. uq20724@bristol.ac.uk  
\*corresponding author

**Abstract:** With the advancement of science and technology and the rapid development of China's economy, China's Internet finance is growing rapidly. As China's Internet finance is in its infancy, a suitable regulatory system has not yet been formed, which leads to many risks in third-party payment, Internet lending, and crowd-funding platforms. This research will specifically explore what risks exist and why they arise, then make some recommendations for them. The findings of this study include recommendations for forward-targeted industry supervisory procedures and preventive actions. In conclusion, China's Internet finance has great potential, and the government should introduce legal provisions and build regulatory agencies to prevent these risks.

**Keywords:** Internet Finance; financial risk; prevention mechanism

## 1. Introduction

Internet finance refers to all financial transactions and organisational structures under the influence of the Internet[1]. Internet finance is the interface between the traditional financial industry with the fast-growing Internet business. While the internet has not overtaken conventional financial institutions, it has created new opportunities for financial organisations to flourish[2]. The online financial industry is growing at a tremendous speed. Alternative financing forms, such as third-party payment platforms, online lending companies, crowdfunding platforms, and internet financial information gateway companies have significantly impacted traditional financial institutions. However, since China's internet finance business is still in its infancy, illicit activities such as illegal fundraising, fraudulent transactions, and money laundering are widespread[3]. Additionally, private information has been compromised, and investor interests have been violated on occasions.

According to Xie's[4] study, China's Internet banking business has risen at a fantastic rate over the last several years. Internet finance provides various advantages over traditional financial services, including low prices, high efficiency, broad coverage, and rapid expansion. Xie evaluates the current condition of Internet finance, discusses the potential risks, and makes recommendations for financial management remedies and risk reduction methods that will aid Chinese internet finance companies in growing fast and efficiently.

Most of the articles introduce the development history of Internet finance in China and the common risks in the financial industry. However, many papers did not consider the unique environment in China. China has been on the internet since 1994. Until 2007, the Internet penetration rate in urban and rural China was only 50% and 18.5% [5]. This makes it difficult for many middle-aged and older

people to accept the Internet. In addition, there is a lack of Internet-related knowledge in the textbooks of young people, which leads to the great curiosity of young people in China about the Internet. However, many young people do not have the opportunity to learn about finance-related knowledge before university. So they are easily deceived by unknown third-party payment platforms and lending software.

This article will specifically analyse the third-party payment platforms, online lending companies, and crowdfunding platforms and the sources of risks in them, and then give possible solutions. For example, Internet finance should be completely incorporated into the legal supervision system and a unified Internet supervision framework needs to be established. The government should strengthen people's Internet knowledge and legal publicity to protect people's property and rights. Hopefully, this will help people better understand the rapid development history of China's Internet finance and the many hidden dangers it brings. This research intends to answer the question of the risks of internet finance while considering the current situation in China as far as internet finance is concerned. This research will contribute to curbing or preventing the dangers that internet finance has brought in the economic development in China. The findings of this study include recommendations for forward-targeted industry supervisory procedures and preventive actions.

## 2. Related Works

Xie Libin undertook the first related research. It was titled Risk Analysis of China's Internet Finance and Strategies. According to this study, China's Internet banking business has risen at a fantastic rate over the last several years[4]. Internet finance provides various advantages over traditional financial services, including low prices, high efficiency, broad coverage, and rapid expansion. Xie evaluates the current condition of Internet finance, discusses the potential risks, and makes recommendations for financial management remedies and risk reduction methods that will aid Chinese internet finance companies in growing fast and efficiently. Because of these advantages of Internet Finance and most Chinese people's insufficient understanding of the Internet and financial knowledge, the risks in China's Internet finance have been expanded.

The other study examined was Liu's Risks and Prevention Strategies of Internet Finance in China. Liu[6] discusses the characteristics of China's major online financial platforms and suggests various ways for mitigating various risks and promoting the development of internet services sustainably. People's personal information occupies a significant position. With the development of big data, people's privacy is becoming more and more transparent on the Internet. Due to the lack of perfect laws and regulations, many mobile applications and computer software can freely obtain users' historical browsing records and even voice records. This leads to many Internet companies can easily find the target population and achieve illegal fraud.

Currently, there are two types of online lending: personal internet loans and petty internet loans. The first is an entirely online experience. The second option is an online or offline configuration. According to Wu[7], on the internet lending company's side, they focus on online wealth management, including publishing lenders' credit card information, following applicable laws, and attracting investors. However, many illegal Internet lending companies are targeting student groups. Because most students lack the knowledge of money and the control of consumption desire. Many students choose to borrow through the Internet to meet their consumption desire and vanity. Obviously, most students don't have a stable financial source, so they can't repay. Therefore, many students continue to borrow money to repay their previous debts, which forms a vicious circle.

Finally, the crowdfunding platform. There are four distinct forms of crowd fund-raising. Crowd fundraising based on donations is the first option. In this model, investors do not care about getting a return on their investment. Another sort of crowd fundraising has a return on investment (ROI). Through acquiring goods or services, the investor made a financial investment in the project or

firm[8]. Ownership crowd financing is the third form. Investors put their money into a business or project in exchange for a portion of the company's stock in hopes of receiving interest and their original investment back. Crowd fundraising for shares is the fourth option. They invest money in a project or business to get a specified proportion of the company stock. One of the most popular forms of crowd fundraising is now stock crowdfunding, which represents the direction in which the industry is headed. However, the most abnormal crowdfunding in China is fundraising for charity. Due to loopholes in the supervision system of the crowdfunding platform and corruption within the company, there are many false charity projects on the charity fund-raising platform. At the same time, the funds of many real charity projects are embezzled by the company's internal personnel.

### 3. Method

#### 3.1. Online transfer

The following data are from the official website of a major traditional bank, ICBC(Industrial and Commercial Bank of China Limited) and the most popular third-party payment platform in China, Alipay.

This research will qualitatively analyse the information and handling charges required in the transfer process of traditional bank online transfer and third-party payment platform online transfer through table comparison.

Table 1: Comparison between traditional online banking transfer and third-party payment platform transfer.

<b>Comparison between traditional online banking transfer and third-party payment platform transfer</b>		
<i>Transfer fees and requirements</i>	<i>ICBC</i>	<i>Alipay</i>
Full name of the payee	Yes	No
Full name of the payer	Yes	No
Account name	19 digit ID	Email address or mobile number
Identity authentication	Yes	No
Upper limit of the transfer fee	25 yuan	10 yuan

Through Tab. 1, we know that traditional banks have strict requirements for the identity information of the payee and the payer. The accounts of both the payee and the payer need to pass identity authentication. Both sides of the transaction are easy to track. However, the transfer between Alipay users only requires an e-mail address or a mobile phone number, and Alipay does not require users to authenticate. At the same time, Alipay has a lower transfer fee. This makes many people choose a third-party payment platform to protect their privacy and spend less when making small transactions.

Despite the apparent benefits of third-party payment platforms, there are certain security risks to be aware of. Commercial transactions often fail to acknowledge the legal status of the opposite party because of security concerns[2]. The records of their transactions are not appropriately preserved or managed systematically when dealing with financial institutions that need genuine identities; some customers use false names, while others cannot accurately identify their consumers. A lack of security

protection systems for authentic client information has made it hard to verify the legality of some transactions over the internet. This is particularly common in people's Internet-related commodity transactions, such as virtual commodities, game props and agent training services.

### 3.2. Internet Lending

The following data are from the official website of a traditional bank, CCB(China Construction Bank Corporation) and an Internet lending company, Pai Pai Dai.

This research will qualitatively analyse the process of traditional lending and Internet lending to explain why people choose Internet lending and why Internet lending companies often fail to recover their debts. The main points are the materials required for the loan, the difficulty of approval, and the way to recover the arrears.

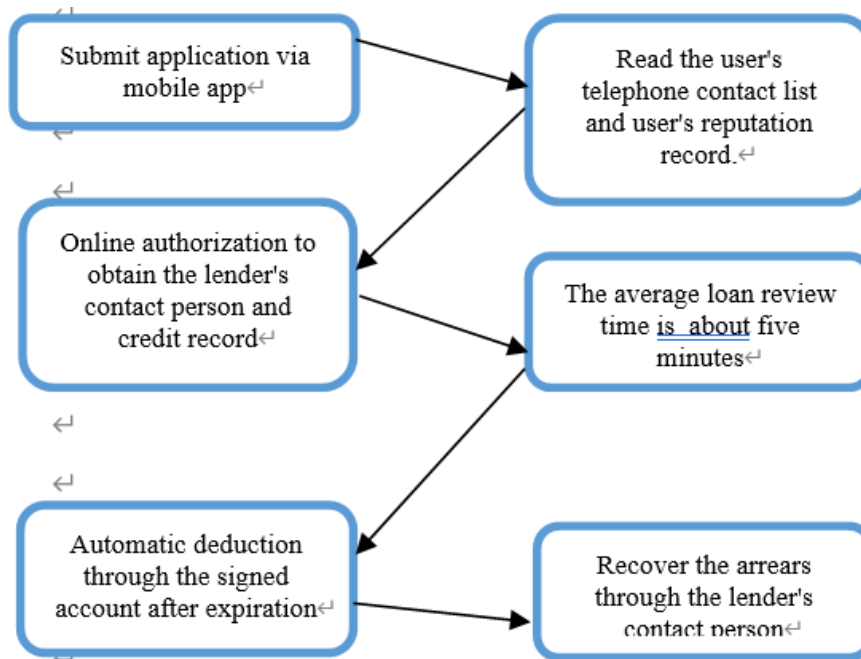


Figure 1: Loan process of Pai Pai Dai.

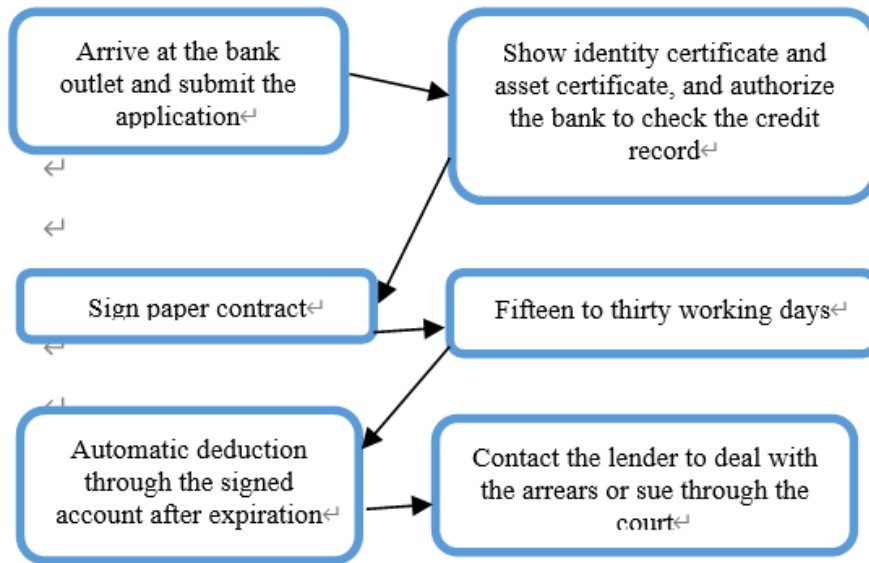


Figure 2: Loan process of CCB.

Through Fig. 1, we know that the loan process of Pai Pai Dai is very simple. Pai Pai Dai will obtain the lender's identity information and contact number and then automatically review the lender's credit record to approve the loan. When the lender fails to repay the loan on time, Pai Pai Dai will not recover the arrears through legal means, but threaten the lender to repay by contacting the contact number left by the lender. This leads to the possibility that the lender may provide false contact information and easily refuse to repay the arrears.

Compared with Pai Pai Dai, CCB has strict requirements for lending. The lender needs to arrive at CCB's office in person and produce paper supporting documents. CCB will spend a lot of time manually reviewing each loan to ensure that the lender has sufficient ability to repay the loan. Even if the lender ultimately fails to repay the loan, CCB also has powerful means to recover the loan legally.

#### 4. Discussion

We know that payments through the internet may be made in one of three ways. The first is via an internet bank gateway, which links the buyer's and seller's respective application systems to the bank system. The payment procedure is complete when the money is sent electronically from the buyer's bank account to the seller's bank account. Various banks have different gateway ports, and the cost of connecting is substantial in this method. The second alternative is to use a financial institution that specialises in online payment for e-commerce to complete a unified payment gateway online payment mechanism [9]. The central bank offers a clearing account for China Union Pay, which meets the online payment function like a commercial bank. Thirdly, there are two ways to pay online: via a third-party payment platform run by an autonomous institution with some influence and a guarantee of good credit, and through a network payment system run by the same two parties [9]. Because the cost of the first method is high and sometimes people want to protect their privacy, they will prefer third-party payment platforms.

As part of the payment procedure, third-party payment institutions keep and deposit funds. At a scale, inefficient liquidity management may cause capital security and payment risk [10]. There is a risk of financial fraud. It is convenient, quick, and secure since most Internet financial transactions occur over the internet and the phone [11]. Antimoney laundering initiatives are harmed by a lack of

consumer comprehension, which verifies their identification and detects suspicious behaviour, transaction details, financial activity detection, and other routine pro laundering efforts.

Besides, Internal system vulnerabilities, staff negligence, and external factors (malicious hacker assaults) pose a loss of danger. There are two interpretations. The first is that the third-party payment platform is vulnerable to hacker attacks, making it more straightforward for internal employees to steal and defraud money. The structure of peer-to-peer lending platforms contains a fault that leads to information being leaked and Internet loans being lost [12]. P2P lending is mainly used by small and micro firms and individuals with a lower credit rating than a financial institution lender, and auditing tends to conceal dangers. As part of the payment procedure, third-party payment institutions keep and deposit funds. At a scale, inefficient liquidity management may cause capital security and payment risk [10]. There is a risk of financial fraud. It is convenient, quick, and secure since most Internet financial transactions occur over the internet and the phone[11]. Antimoney laundering initiatives are harmed by a lack of consumer comprehension, which verifies their identification and detects suspicious behaviour, transaction details, financial activity detection, and other routine pro laundering efforts.

The internet, banking, and information technology all play a role in making online finance more complex. Financial regulators have a big task since it involves various professions. Even though banks and financial institutions may be involved, the primary body of Chinese legal oversight can only deal with the rapid expansion of Internet-based financial firms. This includes establishing national banking and securities laws and insurance laws[13]. Therefore, because of the exponential rise of product kinds and quantities in the Internet financial industry, there has been a steady accumulation of risk that is now poised to burst at any time. Due to China's population and the speed of Internet financial development, it is difficult for the regulatory system to develop well at the same time. The most direct regulatory body is not clear enough to keep track of the Internet's financial activity quickly and effectively. Thus, many government bodies must be involved. For a long time, Internet financial organisations and their ancillary enterprises have been operating in a grey area between legal and illegal[2]. Internet rights and responsibilities are not well-defined, reasonable, and thorough; even some laws and regulations governing financial transactions over the internet are insignificant. A dispute may emerge between the parties' rights and duties whenever a contract is broken. Therefore, enterprises need to strengthen their supervision and maintain an excellent moral bottom line. The government needs to enact relevant laws and issue appropriate teaching materials to protect people's property.

## 5. Conclusion

The financial services business on the Internet in China must be standardised after studying the many dangers. Peer-to-peer lending and crowdfunding should be included in the legal supervision system, their legal status as a firm explained, and their operational area established after supervisory authorities under the government should develop a comprehensive and unified internet regulations framework. This will prevent or help avoid problems caused by lack of improper use of information security, involvement of third parties in internet finance and operation risk.

Improper use of internet banking has resulted in many credit risks, which have led to the big organisation going bankrupt. Therefore, risk control measures should be put in place to curb future credit risks that might occur because of internet finance.

Internet financial transactions must be reinforced to protect sensitive data such as credit card details and bank account numbers, while also verifying the validity of electronic certificates such as digital signatures. Another purpose is to build national standards and guidelines for Internet financial services, to harmonise third-party payment, customer identification, and verification across the country.



The government should also increase the knowledge about Internet Finance in students' textbooks and popularise it for the middle-aged and elderly. Internet lending companies should be strictly prohibited from providing loans to students because most students cannot repay the loan and are prone to excessive consumption impulse due to vanity.

Due to emerging trends in internet banking and the ever-changing environment caused by globalisation, advancement in technology and diverse economic activities, more studies on the effects of internet finance should be done. This will be of great help in avoiding dangers caused by internet finance.

## References

- [1] P. Xie, C. Zou, and H. Liu. "Internet finance in China: introduction and practical approaches." Routledge, 2015.
- [2] Y. Jin. "Research on the Establishment and Improvement for China's Financial Supervision Coordination Legal System." 2017 2nd International Seminar on Education Innovation and Economic Management (SEIEM 2017). Atlantis Press, 2017: 200-203.
- [3] J. Xu. "China's internet finance: A critical review." *China & World Economy*, 2017, 25(4): 78-92.
- [4] X. Libin. "Risk Analysis of China's Internet Finance and Strategies." 2018 International Conference on Economy, Management and Entrepreneurship (ICOEME 2018). Atlantis Press, 2018.
- [5] T. Lawton. "Rural Internet Usage in China – Infographic and Interview." *East-West-Connect.com*, 2013.
- [6] H. Liu. "Risks and Prevention Strategies of Internet Finance in China." 3rd International Conference on Culture, Education and Economic Development of Modern Society (ICCESE 2019). Atlantis Press, 2019: 1802-1806.
- [7] Q. Wu. "Internet Finance and Financing Innovation of Small and Micro Enterprises." *International Conference on Big Data Analytics for Cyber-Physical-Systems*. Springer, Singapore, 2020: 982-986.
- [8] C. Bai, H. Yan, S. Yin, et al. "Exploring the development trend of internet finance in China: Perspective from club convergence." *The North American Journal of Economics and Finance*, 2021, 58: 101505.
- [9] J. Ma. "Research on small and micro-enterprise financing model innovation from the perspective of internet finance." *Times Finance* (03), 54–55 (2019). (in Chinese)
- [10] B. Jiang, Q. He, and J. Wang. "Internet Financial Regulation and Financial Consumer Protection[C]." 2016 7th International Conference on Education, Management, Computer and Medicine (EMCM 2016). Atlantis Press, 2017: 49-54.
- [11] B. Wang, L. Zheng, and Z. Wang. "The Analysis and Regulation of Internet Finance Risk from the Perspective of Overall National Security." 2nd International Conference on Judicial, Administrative and Humanitarian Problems of State Structures and Economic Subjects (JAHP 2017). Atlantis Press. 2017.
- [12] J. Wang. "Inclusion or expulsion: Digital technologies and the new power relations in China's 'Internet finance'." *Communication and the Public*, 2018, 3(1): 34-45.
- [13] W. Zhong, and T. Jiang. "Can internet finance alleviate the exclusiveness of traditional finance? evidence from Chinese P2P lending markets." *Finance Research Letters*, 2021, 40: 101731.
- [14] Z. Tian, and H. Ahmad FS. "INTERNET FINANCE AND ITS POTENTIAL RISKS: THE CASE OF CHINA." *International Journal of Accounting*, 2019, 4(20): 45-51.