

**Nagoya University Graduate School of Law**

**THE REGULATORY FRAMEWORK OF PEER-TO-PEER LENDING IN CHINA  
A PERSPECTIVE ON THE MECHANISM OF SOFT-LAW AND CO-REGULATION**

**Doctoral Thesis in Law**

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## **Abstract**

The industry of Peer-to-Peer lending (hereafter P2P lending) in China grows up rapidly in recent years. Meanwhile, there are also huge number of investors suffering from losing their investment. Ezubao (e 租宝), a P2P lending platform in China, regarded as perpetrating the largest Ponzi scheme in P2P lending history of China, there are at least 900,000 victims involved, with a total cumulative loss amount of nearly 50 billion CNY. According to statistics, there are still 746 P2P lending platforms going bankruptcy in 2015. Nevertheless, there is no remarkable effects of regulation in China.

In addition to government regulation, recent literature has suggested that self-regulation system of P2P lending as the UK should be introduced in Chinese market. However, this research argues that it is not realistic for directly borrowing the practice in the UK because their history, industry practice, and market structure are different, especially independence from government. Aside from aforementioned discussions, there are scholars advocating CRAs working as third party supervision toward P2P lending industry. Nonetheless, there is no statistics to support their argument. In order to support above argument, this dissertation conducts an empirical research with a questionnaire for understanding its relevant background. With the empirical study in China, this Dissertation found that CRAs could enhance disclosure duty of P2P lending platforms. Nevertheless, the statistics also show the concern of the objectiveness of CRAs.

This research suggests the ideal regulatory model of Chinese P2P lending is co-regulation. Specifically, Chinese P2P lending is regulated by CRAs from soft-law perspective for pursuing market transparency and improving ineffectiveness of regulatory framework currently. Additionally, CRAs of P2P lending should be regulated by government regulation from hard-law perspective for

pursuing objectiveness and establishing reliable rating system. Without objectiveness, rating report provided by CRAs could not have effect on improving market transparency.

Keywords: Credit Rating Agencies (CRAs), Disclosure Duty, Peer-to-Peer lending (P2P Lending), Transparency, Independence

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### **Statement of Originality**

I, Hung-Yi Chen declare that this dissertation is my own work and has not been submitted in any form for another degree or diploma at any university or other institute of tertiary education.

Information derived from the published and unpublished work of others has been acknowledged in the text and a list of references is given in the bibliography.

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## List of Abbreviations

ASEAN	Association of South East Asian Nations
CBRC	China Banking Regulatory Commission
CRAs	Credit Rating Agencies
CSRC	China Securities Regulatory Commission
ESB	Emerging Stock Board
FCA	Financial Conduct Authority
FSA	Financial Services Authority
FSC	Financial Supervisory Commission
GISA	Go Incubation Board for Startup and Acceleration Firms
GSB	General Stock Board
IPO	Initial Public Offerings
ISA	Individual Savings Accounts
NDRC	National Development and Reform Commission
NIFA	National Internet Finance Association
OFT	Office of Fair Trading
OTC	Over-The-Counter
PBC	People's Bank of China
SEC	Securities and Exchange Commission
SME	Small and Medium Enterprises

## Chapter 1 Introduction

Peer-to-Peer lending is a mechanism of lending without a conventional bank. This is an intermediary system for people doing lending or borrowing funding on the Internet. P2P lending provides high-technology services to reduce the cost of manually examining of each person's financial credit. For reasons of efficiency, P2P lending platforms can be a supplement to the current banking system, especially in micro finance. However, this study found there are several major problems of P2P lending in Chinese market, which may deter its further development because of four factors which includes (1) lack of market transparency, (2) ineffectiveness of current regulation, (3) imperfect independence of industry association, and (4) defective objectiveness of credit rating report in Chinese P2P lending.

### 1.1. Problems of Peer-to-Peer Lending in China

#### 1.1.1.Lack of Market Transparency

The industry of Peer-to-Peer lending (P2P Lending) in China develops rapidly in recent years. Meanwhile, there are also many P2P lending platforms going into bankruptcy and a huge number of investors have been suffering from losing their investment<sup>1</sup>. In December 2015, Ezubao (e 租宝) is regarded as perpetrating the largest Ponzi scheme in P2P lending history of China<sup>2</sup>. According to a

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<sup>1</sup> Xinhua, "Lending Scheme Fraudster Jailed for Life," Online News, *Xinhua*, (July 5, 2016).

<sup>2</sup> Samuel Shen and John Ruwitch, "China Police Arrest 21 over \$7.6 Bln Online Financial Scam," Online News, *Reuters*, (February 1, 2016).

recent report that tracks Ezubao, at least 900,000 victims are involved, with a total cumulative amount of nearly 50 billion CNY<sup>3</sup>.

In order to attract capital from investors, P2P lending platforms engaging Ponzi scheme normally promise their investors a high interest rates from qualified borrowers with good credits or collaterals. However, purported borrowers on P2P lending platforms may not be existed. In order to attract investors, some P2P lending platforms tend to list some fake loan project with high return rates. Hence, the interests of investors are paid by money received from later investors rather than borrowers. The information between investors and a platform is asymmetry. Accordingly, some P2P lending platforms do not provide true information and investors have not enough ability to evaluate the information provided by a platform in Chinese market.

Ezubao is not the only case of Ponzi scheme by P2P lending business. In May 2016, Esudai (e 速贷), a P2P lending platform established in 2010, is alleged that Esudai illegally took in deposits from the general public under Article 176 of Criminal in China by the police office of Huizhou, Guangdong province of China. The case of Esudai involved at least 330,000 investors and 7 billion CNY<sup>4</sup>. As a result, the market transparency of Chinese P2P lending industry at this stage needs to be improved, especially the asymmetry information between a P2P lending platform and investors, which causes a lot of frauds by Ponzi scheme.

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<sup>3</sup> Ibid.

<sup>4</sup> Elias Glenn, "China Online Lending Crackdown Shatters Guangdong P2P Site," Online News, *Reuters*, (May 26, 2016).

### 1.1.2. Ineffectiveness of Current Regulation

Relevant authorities in China, such as China Banking Regulatory Commission (CBRC) in central government level<sup>5</sup>, Economic Crime Investigation Detachment and Bureau of Financial Work in every municipality, have already taken measures for addressing the large-scale wave of bankruptcy in P2P lending industry. Even with all the efforts of regulatory agencies in China, guidelines and proposed bills, many significant frauds caused by P2P lending continued not undetected in China for years until they developed at large scale of both their swindled investors and illegal capital amount. Moreover, these frauds of P2P lending platforms have been conducted repeatedly and severely in recent years. The scale of defrauded investors and whole amount of investment in China may still not be fully unveiled because only huge damages have high possibility of being reported by mass media and concerned by judicial authorities.

Already 38 cases have been decided by local court or high court since 2013 based on electric judicial database in China<sup>6</sup>. All of these cases resulted with imprisonment or fine. The average penalty of prison is around five years<sup>7</sup>. Under current legal framework, frauds of P2P lending are solved by criminal law. According to statistics published by Wangdaizhijia (网贷之家)<sup>8</sup>, one of CRAs in Chinese P2P lending industry, there are 746 P2P lending platforms going bankruptcy in 2015. Compared to statistics in 2014, which is 254, the number of problematic platform of P2P lending increased almost three times.

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<sup>5</sup> Shaohui Tian, "China Tightens Regulation over P2P Lending," Online News, *Xinhua*, (December 28, 2015).

<sup>6</sup> China Judgements Online [中国裁判文书网], "China Judgements Online" [中国裁判文书网], Electronic Judicial System, 中国裁判文书网, (July 11, 2016).

<sup>7</sup> Ibid. See Appendix 1.

<sup>8</sup> Wangdaizhijia [网贷之家], "Updated List of Problematic P2P Lending Platforms" [最新停业网贷平台和问题网贷平台列表], 网贷之家, July 11, 2016.

Consequently, even with Chinese government regulatory authorities under extreme pressure and providing several guidelines to deter Ponzi scheme caused by P2P lending from 2011<sup>9</sup>, many Ponzi schemes resulted from P2P lending have operated for several years and wreak tremendous damages on the lives of innocent investors and the economy as well. The current regulation against fraud of Chinese P2P lending is still ineffective.

### 1.1.3. Imperfect Independence of Industry Association

The industry association of P2P lending in the UK, P2PFA, is a fundamental part of regulating P2P lending industry before relevant regulation is issued by the UK authorities. Recent literature<sup>10</sup> have suggested that self-regulation system of P2P lending as the UK should be taken into consideration for developing relevant regulation in China. However, this dissertation argues that it is not realistic for borrowing the concept of self-regulation in the UK, which is association-based system to be implemented into China. The association in the UK is market-driven, as shown in part (b) of , the association is bottom-up mechanism and have mutual communication channel with government. In contrast, associations relating to P2P lending in China is relatively government-driven<sup>11</sup>, such as National Internet Finance Association of China (NIFA), as shown in part (a) of ,

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<sup>9</sup> China Banking Regulatory Commission, Notice of the General Office of China Banking Regulatory Commission on Warning of Risks Associated with Peer-to-Peer Lending [中国银监会办公厅关于人人贷有关风险提示的通知] (People's Republic of China|CN 2011.8.23).

<sup>10</sup> Deng Jianpeng (邓建鹏) and Huang Zhen (黄震), "The Soft Law of Internet Finance: Problems and Directions" [互联网金融的软法治理：问题和路径], *Financial Regulation Research* [金融监管研究], February 2016, 68–72. Huang Zhen (黄震) et al., "The Comparative Study of P2P Lending Regulation in the United Kingdom and the United States and Its Reflection to Chinese P2P Lending" [英美 P2P 监管体系比较与我国 P2P 监管思路研究], *Financial Regulation Research* [金融监管研究], October 2014.

<sup>11</sup> Sun Chunmiao (孙春苗), *The Research of Industry Association Failure in China* [论行业协会：中国行业协会失灵研究] (Beijing: China Social Sciences Press, 2010), 9–10.

the association is more like top-down mechanism. In this regard, the industry association may be extension of power from government in China rather than autonomy for self-regulation in the UK. Specifically, there remains the gap of association practice between the UK and China. Without independence, the self-regulation function may not be realized.

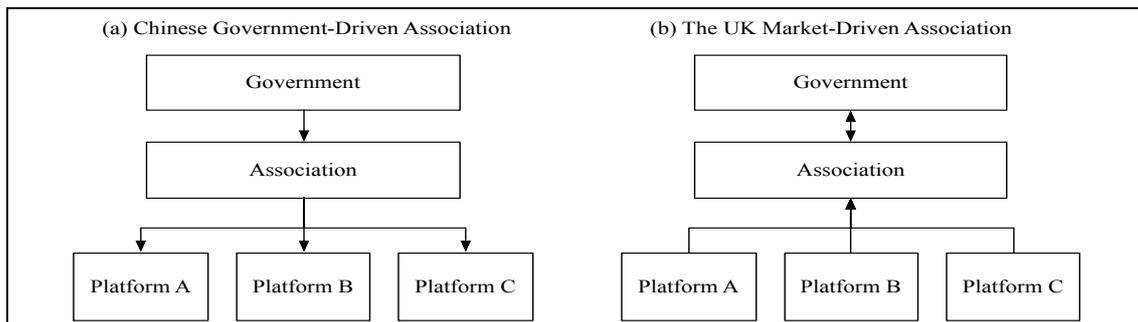


Figure 1: The Difference of P2P Lending Association in China and the UK

Source: The figure is constructed by author

#### 1.1.4. Defective Objectiveness of Credit Rating Report in Chinese P2P lending

Without sophisticated practice and independence of association mechanism as the UK in China, it is difficult to have functionalized association. Therefore, this dissertation argues that credit-rating agencies of P2P lending in China, as shown in part (c) of Figure 2, which are unique features and market-driven based<sup>12</sup>, existed for several years, should be considered as a choice to reduce asymmetry information issue between P2P lending platforms and investors, addressing recent problems of P2P lending platforms. In other words, how to enhance market transparency for

<sup>12</sup> Despite that P2P lending has developed in the US and the UK for several years, the number of P2P lending platforms are not as much as in China, which may explain why there is no credit-rating agencies of P2P lending in the US and the UK.

reducing information asymmetry<sup>13</sup> through credit-rating agencies of P2P lending industry as supporting current legal mechanism in China is a critical issue in Chinese P2P lending industry.

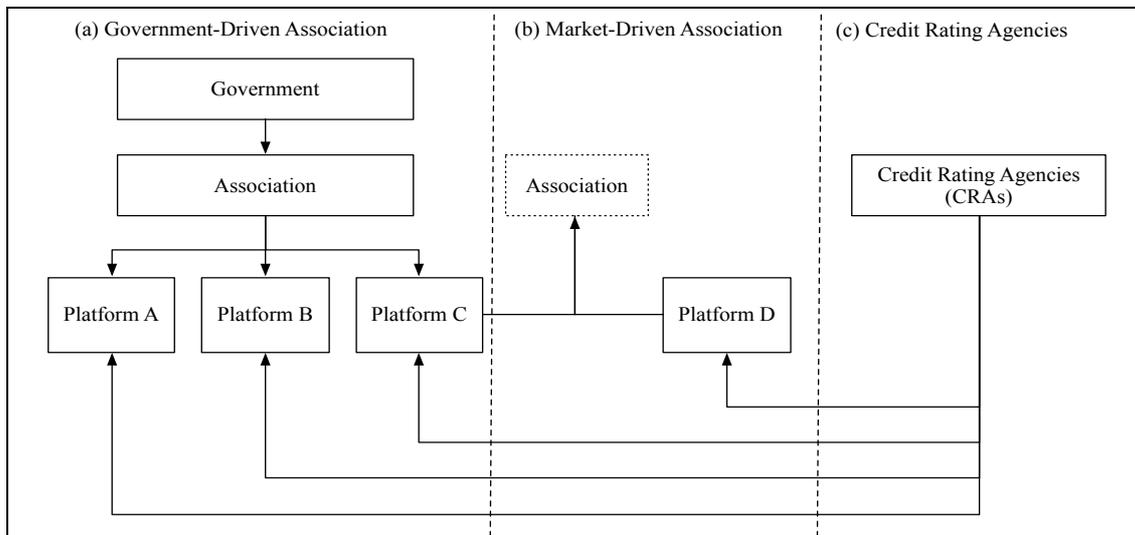


Figure 2: The soft-law system of P2P lending in China

Source: The figure is constructed by author

Moreover, this study also finds that issues of corruption of CRAs should not be ignored. The evaluating process of a rating report published by CRAs is relatively not transparency. CRAs may charge “advisory fee” for promising upgrading rank of a P2P lending platform<sup>14</sup> as a P2P lending platform with poor performance may tend to pursue their ranking in rating report<sup>15</sup>.

<sup>13</sup> Uekusa Masu (植草益), *Economics of Social Regulation* [社会的規制の経済学] (Tokyo: NTT, 1997), 158–59. “...The result that suppliers misuse their position owning information and the fact that consumer is lack of information will hinder the best distribution of recourses in the society...” (...問題は、情報を私的に保有している供給者が消費者の情報の不完全を利用して機会主義的に行動する結果、社会的に最適な資源が妨げられてしまうところにある...)

<sup>14</sup> Caijing [财经网], “Whether Credit-Rating Agencies of P2P Lending Misleads Industry or Not” [乱象丛生：P2P 网贷评级到底是引导者还是误导者？], 财经网, May 6, 2016.

<sup>15</sup> Ibid.

Though CRAs are regulated by several regulations in China, the definition and scope only cover CRAs of debt market rather than P2P lending<sup>16</sup>. Namely, there is no specific regulation for dealing with corruption caused by rating report of P2P lending in China. Without auxiliary measures for reducing risks of CRAs of P2P lending in China, the goal of disclosure for market transparency could not be realized. In other words, the objectiveness of CRAs is necessary to be ensured to gain the trust from investors. Based on the trust from investors, the ranking provided by CRAs will have regulatory impact on P2P lending platforms. Therefore, this study is dedicated to developing mechanism of improving objectiveness of CRAs in Chinese P2P lending industry. The objectiveness of report published by CRAs in Chinese P2P lending industry is not yet solved and need to be improved.

## 1.2. Research Questions

This dissertation addresses a series of questions. Firstly, the core and broadest question is whether the leading model of self-regulation of P2P lending industry in the UK, Peer-to-Peer Lending Finance Association, could be borrowed and implemented in Chinese P2P lending market for enhancing market transparency of P2P lending platforms for addressing P2P lending frauds in China. Secondly, if it is not practical and efficient for above legal transplantation, the question that follows is what kind of institution is suitable and efficient for improving market transparency under consideration of history, industry practice, and market structure in Chinese P2P lending market. Could existing CRAs of Chinese P2P lending be an alternative choice for further development?

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<sup>16</sup> Deng Jianpeng (邓建鹏), “The Necessity of Credit-Rating Agency in P2P Lending: Based on First Case of Credit-Rating of P2P Lending” [网贷评级是时代之需——对“网贷评级第一案”的思考], *The Chinese Banker* [银行家], February 2016.

Finally, the last is whether it is possible to improve existing CRAs of P2P lending and develop them as self-regulation system in Chinese P2P lending industry for enhancing market transparency.

### 1.3. Research Motivation

At the root of this dissertation lies questions of fundamental importance, which is why investigate P2P lending in China? Since there are many leading P2P lending markets in the world, such as the UK and the US, why does this dissertation select China as a target for conducting the research. Comparing with the UK and the US, Chinese market is relatively large and increases rapidly. The industry of P2P lending in China has developed for almost nine years since 2007. Until 2015, the amount of P2P Lending market in China is estimated to be more than \$30 billion, which shows the importance and necessity of promoting P2P lending in Chinese capital market. However, because of lack of market transparency, the issue of P2P lending and its problems has been widely discussed by scholars. Generally, from institutional perspectives, there are three major diversified arguments advocated by scholars, which includes regulation by government, self-regulation by the industry association, and third-party supervision by CRAs.

Peng<sup>17</sup>, a Professor in law at Beijing University, argued that P2P lending should be defined as micro loan. Consequently, the amount and investors of a P2P lending loan should be limited, for instance, the amount of a P2P lending loan fundraised by a person should be under 200,000 CNY within the maximum amount of 30 investors. In case of legal person, the amount of a P2P lending is under one million CNY within the maximum amount of 150 investors. However, there remains the

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<sup>17</sup> Peng Bing (彭冰), “P2P Lending and Illegal Fundraising” [P2P 网贷与非法集资], *Financial Regulation Research* [金融监管研究], June 2014, 23–24.

concern on how to provide a feasible standard for meeting demand from market, especially a modern society with rapid changes.

In addition to government regulation, Huang<sup>18</sup>, a Professor in law at Central University of Finance and Economics, indicated that the practice of self-regulation by the industry association of P2P lending in the UK could be implemented into China for supplementing insufficient regulation by government. Deng<sup>19</sup>, a Professor in law at Minzu University of China, argued that although self-regulation may be an alternative choice, self-regulations rules provided by the industry association of P2P lending in China lack enforcement power at the moment. Both Huang and Deng focus only on the mechanism of P2P Finance Association in the UK rather than industry association from general viewpoints. Without considering the disparities of industry association mechanism between the UK and China, it is not persuasive to prove its feasibility of implementing into China.

Aside from discussions of regulation by government and self-regulation by the industry association, there are also some scholars<sup>20</sup> advocating CRAs working as third party supervision toward P2P lending industry. Nonetheless, there is no statistics to support their argument that CRAs have impact in terms of regulatory impact on P2P lending platform in China.

Hence, this Dissertation finds it is necessary to have analysis whether regulation provided by government is feasible or not. Following discussion of self-regulation by the association in the UK, this study conducts a comparative study between China and the UK from economical, hard-law,

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<sup>18</sup> Huang et al., “The Comparative Study of P2P Lending Regulation in the United Kingdom and the United States and Its Reflection to Chinese P2P Lending,” 57.

<sup>19</sup> Deng and Huang, “The Soft Law of Internet Finance: Problems and Directions,” 69–70.

<sup>20</sup> Deng, “The Necessity of Credit-Rating Agency in P2P Lending: Based on First Case of Credit-Rating of P2P Lending.” Zhou Huihong (周慧虹), “The Mechanism of Credit Rating and Its Support on P2P Lending” [信用评级助力网贷平台走稳], *Financial View* [金融博览], April 2015. Zhi Fengyin (植凤寅) et al., “Who Owns the Power of Credit Rating of P2P Lending?” [网贷评级谁说了算], *China Finance* [中国金融], February 2016.

soft-law, and co-regulation perspectives for a comprehensive overview. Finally, in order to support argument of CRAs working as third party supervisory system for Chinese P2P lending, this dissertation conducts an empirical research with a questionnaire for understanding its background.

## 1.4. Research Methodology

### 1.4.1. Comparative Study

This study combines two different methodological approaches. One approach is analysis by soft-law. Generally, there are divergent approaches for developing relevant regulation toward P2P lending industry in China for reducing side effects and enhancing market transparency of this industry. In this dissertation, one category could be understood as hard-law and soft-law<sup>21</sup>. Specifically, the example of hard-law is P2P lending industry bill<sup>22</sup> proposed by CBRC on December 2015. Associations both in national and local<sup>23</sup> levels relating to P2P lending established recently in China and also CRAs<sup>24</sup> of P2P lending<sup>25</sup> developed several years providing rating report

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<sup>21</sup> Nakayama Nobuhiro (中山信弘), *The Theory of Soft-Law* [ソフトローの基礎理論] (Tokyo: Yuhikaku, 2008). Soft-law could be understood as although there is no guarantee of enforcement by court or other government entities, enterprise or private individual still follow these rules in practical. (裁判所等の国家機関によるエンフォースが保証されていないにもかかわらず、企業や私人の行動を事実上拘束している規範。)

<sup>22</sup> Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Institutions [网络借贷信息中介机构业务活动管理暂行办法] (People's Republic of China|CN 2016.8.24).

<sup>23</sup> Guo Feng (郭峰), "Industry Association in China and Self-Regulation of P2P Lending" [中国式行业协会与 P2P 网络借贷的自律管理], 中国金融四十人论坛工作论文系列, 2016. Such as National Internet Finance Association of China (中国互联网金融协会) in central level and Beijing P2P Industry Association (北京市网贷行业协会) in local level.

<sup>24</sup> *Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Markets*, (Securities and Exchange Commission, January 2003).

<sup>25</sup> Wangdaizhijia, P2PEYE, Rong 360, are Credit-rating agencies of P2P lending in China, which issue rating report of P2P lending platforms.

can be regarded as soft-law. Another category in this study for classifying these approaches from an institutional perspective includes the industry association and CRAs.

#### 1.4.2. Empirical Data

The second methodological approach is the questionnaire consisted of 20 items and is divided into five sections, the first of which was intended to elicit demographic information on the respondents<sup>26</sup>. The second section asked respondents to answer their familiarity regarding CRAs of P2P lending in China. The third section focused on respondents who had experiences of P2P lending investment and their investing tendency. The fourth section was designed to assess opinions and attitudes of respondents towards Chinese crediting rating agencies of P2P lending, which is a vital part of the whole survey. This questionnaire has also designed some open-ended research problems, which tried to understand the reliability of their responses and also explore the research problems of this dissertation.

##### 1.4.2.1. Subjects and Instruments

The subjects who volunteered to take part in the study were 214 Chinese users (91 women, 123 men) of Baidu, the largest search engine in China, which provides on-demand survey service. The survey service provided by Baidu has been reported that there are 17 million samples covered by 300 cities in China in their database. Besides, this survey service also could specify certain groups for survey based on their behaviors on searching engine. In order to enhance the reliability of this

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<sup>26</sup> Appendix 2

study, there were 76 participants of the sample who were selected as they were interested in finance area and had experience of P2P lending investment. Although most users of P2P lending may have interested in finance, there still remains some users regarding P2P lending investment as their second interest.

#### 1.4.2.2. Data Collection Procedure

Data collection took place on October 2016. In order to prevent duplicated sample filling out this survey, the following measures were adopted, including respondents need to enter verified code before they participate this survey; same IP address was not allowed to submit repeatedly; same user of Baidu was not allowed to submit repeatedly; the users are limited to those who already verify their identity by cell phone SMS; and similar responses are excluded. In addition to above anti-cheating mechanisms provided by survey company, this study also verified the reliability of their respondents by examining their response to open-ended research questions. As some respondents do not pass above verification, this study decided to exclude seven samples for increase accuracy of this study.

#### 1.4.2.3. Data Analysis and Verification

Although this survey has wide coverage from diversified participants and establishes mechanism for preventing void sample, the results must be interpreted cautiously as the questionnaire are not directly distributed by author but survey company, Baidu. The concern of authenticity may be remained to some extent. In order to reduce concern of indirect distribution of this survey to a minimum, this study was also compared with another survey provided by a third

party for authenticity, for example, this research compared question 3 “the most CRAs of P2P lending you used” with the trend index provided by Baidu. In addition, this study also divided distribution of this questionnaire into different phases as the results may be influenced and distorted due to a limited sample. Therefore, this study has expanded its sample by conducting this survey three times without the same participants.

### 1.5. Summary of Chapters

Chapter 1 briefly discusses the key aspects of P2P lending in China by pointing out relevant problems addressed by this dissertation, which includes lack of market transparency, ineffectiveness of current regulation, imperfect independence of industry association, and defective objectiveness of CRAs in Chinese P2P lending industry.

Chapter 2 firstly indicates that the rapid and diversified development of modern society increases the burden of government sector. The regulatory role of government has highly been challenged, for instance, the industry of financial technologies, known as Fintech, has been widely spread in recent years. Without enough knowledge of this innovative industry, financial authorities face difficulties of their poor regulation, over-regulation, and under-regulation, which show the ineffectiveness of hard-law on innovative industry. In order to pursue regulatory effectiveness, this dissertation analyzes the role of soft-law from institutional perspectives, including industry association and CRAs. Nonetheless, the issues, such as anti-competition in industry association and abuse of discourse power in CRAs should be regulated by hard-law. Therefore, hard-law should be assisted by soft-law to improve its effectiveness in modern society and soft-law should be supported

by hard-law to ensure its legitimacy. The co-regulation between hard-law and soft-law become indispensable in modern society.

Chapter 3 provides background information about P2P lending and its regulatory development in the United Kingdom and China including economical, hard-law, soft-law, and co-regulation perspective to understand the structure of market characteristics and successful factors how public and private sectors working together to pursuing market transparency in British and Chinese P2P lending industry. This chapter further examines whether relevant regulations in the United Kingdom may be implement into Chinese market and found that history, industry practice, and market structure between these two countries remains a huge gap to achieving the goal.

Chapter 4 attempts to seek alternative regulatory models and argues that CRAs of P2P lending is more applicable in China to enhance market transparency. In order to prove this hypothesis, this Chapter provides an empirical analysis on CRAs of P2P lending in China and found its positive impact on P2P lending industry. However, this Chapter also indicates the problems of CRAs, such as objectiveness, is not solved yet. This chapter further analyzes whether CRAs of P2P lending are regulated and how to regulate for enhancing market transparency of P2P lending. This part found that CRAs of P2P lending are neither regulated by current regulations nor proposed bills. Relevant measures, such as independence, rule of avoidance, disclosure, and liability should be taken into consideration of its regulatory framework.

Chapter 5 concludes that a mixture regulatory framework between hard-law and soft-law is indispensable in the rapid and diversified development of modern society, especially Fintech, such as P2P lending in China. Therefore, this dissertation analyzes the soft-law from institutional perspectives, including industry association and CRAs. The soft-law role of industry association in

the UK is highly based on its independence. Without similar characteristics, it is difficult to transplant into China at the moment. Given that CRAs are constituted by a third-party rather than stakeholders of industry association, the independence may be more easily ensured in Chinese market. Nonetheless, abuse of discourse power by CRAs, such as corruption and over-ranking, should be prevented by hard-law. Consequently, this dissertation proposes that the P2P lending industry in China should be co-regulated by CRAs from soft-law perspective with supporting measures from hard-law to ensure the function of CRAs.

## Chapter 2 Hard-Law and Soft-Law

The rapid and diversified development of modern society increases the burden of government sector. The regulatory role of government has highly been challenged. For instance, the regulatory framework of financial technologies, known as Fintech, such as P2P lending which has been widely challenged. Without enough knowledge of this innovative industry, financial authorities face difficulties of their bad regulation, over-regulation, and under-regulation, which shows the ineffectiveness of hard-law on innovative industry. In order to pursue regulatory effectiveness, this dissertation analyzes the role of soft-law from institutional perspectives, including industry association and CRAs. Nonetheless, the issues, such as anti-competition in industry association and abuse of discourse power in CRAs should be regulated by hard-law. Consequently, hard-law should be assisted by soft-law to improve its effectiveness in modern society. And soft-law should be supported by hard-law to ensure its legitimacy. The co-regulation between hard-law and soft-law is indispensable for developing regulatory framework.

### 2.1. Hard-Law Perspective: Limitation on Financial Technologies

With the development of technology and the growth of internet users in the world, the business model of crowdfunding become popular recently. There are several categories of crowdfunding, for instance, donation-based, reward-based, and investment-based crowdfunding in general. Because of legal requirements, investment-based crowdfunding, such as P2P lending discussed in this dissertation as well as equity-based crowdfunding, are controversial and highly debated in most

jurisdictions. Hence, relevant financial regulations are challenged by crowdfunding industry, especially those business models overlapping with business regulated by Bank Act, Securities Act, and so forth. The activities of investment are normally highly regulated in order to ensure protection of investors and market stability.

However, traditional requirements of financial institutions are complicated and not feasible to crowdfunding platform as most of them are startups and lack capability in legal compliance cost. Moreover, financial authorities may not be familiar with this innovative industry at the moment. In addition, the development of crowdfunding industry changes rapidly, which cause potential failure of legislation. Accordingly, it is important to understand applicability of relevant legislation and policies provided by government, hard-law. Therefore, following section seeks to analyze the effectiveness of regulatory framework regarding investment-based crowdfunding from hard-law perspectives.

According to the report of alternative finance published through Cambridge Centre for Alternative Finance, University of Cambridge<sup>27</sup>, industry people participated the survey of report indicated that the regulation is inadequate, for instance, 50% in India, 45.45% in Singapore, and 33.33% in Thailand, which could be represented as under-regulation. Moreover, industry people also claims that the regulation is too strict, for example, 50% in Japan, 50% in Thailand, and 36.36% in Korea, which could be regarded as over-regulation. Therefore, more than half of targeted countries<sup>28</sup>, such as India, Japan, Korea, Singapore, and Thailand, face difficulties about their over-regulation and under regulation on Fintech industry. Additionally, this study also indicated that regulation in

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<sup>27</sup> Zhang Bryan et al., *Harnessing Potential: The Asia-Pacific Alternative Finance Benchmarking Report*, (Cambridge Centre for Alternative Finance, et al., March 2016).

<sup>28</sup> Ibid. Malaysia, New Zealand, Australia, India, Japan, Singapore, Thailand, Korea

China is inadequate, specifically 53.85% in P2P real-estate lending, 47.9% in P2P business lending, and 42.68% in P2P consumer lending. From aforementioned statistics, relevant regulation provided by financial authorities for promoting Fintech industry may not meet the requirement of industry people or promote this industry.

As proposed regulation of P2P lending in China has still not commenced yet and equity-crowdfunding share similar concepts with P2P lending in China<sup>29</sup>, this chapter selects equity-crowdfunding for analysis. In addition, because Japan and Taiwan are regarded as first three countries in East-Asia region legalizing equity-based crowdfunding<sup>30</sup>, it is important to understand its development for these couple of years and analyze the limitation of their hard-law practice and failure, especially over-regulation.

#### 2.1.1. Case Study: The Failure of Hard-Law Approach

The difficulties of fundraising among startups are universal issues in the world. Startups do not have enough credit or collateral to fundraise capital from the bank. Meanwhile, a few of them have opportunities to attract the investment from venture capital. However, the most influential companies, such as Facebook and Google, have experienced the stage of startups and finally becomes extremely successful. In order to encourage the development of startups, the United States provides the financial regulation, “Jumpstart Our Business Startups Act” (JOBS Act), which allows startups to issue their stock to general public by equity-crowdfunding at low legal cost.

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<sup>29</sup> Compared with traditional fundraising channels, both equity-crowdfunding and P2P lending tend to focus on small amount of capital raised by general public.

<sup>30</sup> Malaysia (February 2015), Taiwan (April, 2015), and Japan (May 2015)

After the experiences in the United States, it became prosperous among Asian countries in 2015. Malaysia, Taiwan and Japan already amended their current financial regulation to allow equity crowdfunding as a new fundraising channel for startups<sup>31</sup>. However, it remains the gap between policy maker and practitioner, for example, the cap amount of fundraising, which will be addressed in following section.

#### 2.1.1.1. Equity-crowdfunding in Japan

In order to utilize idle household financial assets in Japan into investment for economic growth and encouraging startups, 2014 Amendment of the Financial Instruments and Exchange Act in Japan has introduced several fundraising channels, including equity-based crowdfunding, which has been implemented on May 29, 2015. Following discussions with practitioners, scholars, and government officials, Financial Services Agency, financial authorities in Japan provided exemptions for being Financial Instruments Business Operator that is only focusing on equity-based crowdfunding or solicitation of investment in partnership rights, which is quite similar to royalty-based crowdfunding.

Therefore, for being Financial Instruments Business Operator of equity-based crowdfunding, the minimum capital requirement is 10 million JPY (around 88,318 USD), compared with the capital amount of conventional Type I Financial Instruments Business Operator, which is 50 million JPY (around 441,594 USD). Hence, Financial Instruments Business Operator of solicitation of investment in partnership rights, the minimum capital requirement is five million JPY (around

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<sup>31</sup> *Guidelines on Recognized Markets (Malaysia|MY 2015)*. Hung-Yi Chen, “The New Crowdfunding Market in Asia: Taiwan,” Industry News, *Crowdfund Insider*, (May 8, 2015). Pawee Jenweeranon, “The Establishment of Equity Crowdfunding in Thailand & the Strengthening of Thai SMEs for the ASEAN Single Market,” Industry News, *Crowdfund Insider*, (May 25, 2015).

44,159 USD), compared with the capital amount of conventional Type II Financial Instruments Business Operator, which is 10 million JPY (around 88,318 USD).

Based on Financial Instruments and Exchange Act<sup>32</sup>, the issuer of securities who intends to fundraise capital of more than 100 million JPY should submit their Securities Registration Statement. Consequently, for those companies which want to do fundraising on crowdfunding platforms in Japan, their fundraising on all crowdfunding platforms in Japan should be under 100 million JPY (around 883,189 USD) per year. In order to protect the right of non-accredited investors, the maximum of investing fundraising project is 500,000 JPY (around 4,415 USD) per year.

Though equity-crowdfunding is already allowed to operate in Japan, there is no company registering as platform until now. Hence, it is important to understand the online social lending business in Japan for exploring possibilities of regulatory failure. Under the financial regulation in Japan, anyone who engages in Money Lending Business in Japan without exemption should register as Money Lenders as provided in the Money Lending Business Act<sup>33</sup>. However, it is unlikely for each investor to register as Money Lenders. Therefore, social lending platforms in Japan have to register as Money Lenders. A social lending platform will establish the contract of investment between a platform and investors by the scheme of Tokumei Kumiai<sup>34</sup> (a silent partnership contract). Since social lending platforms working as an agency between investors and borrower, they need to register as Type I or Type II Financial Instruments Business Operator for gathering investors publicly. Though the minimum capital requirements of working as a broker of Tokumei Kumiai may

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<sup>32</sup> Financial Instruments and Exchange Act of Japan, Article 4-5

<sup>33</sup> Money Lending Business Act of Japan, Article 2, Article 3, and Article 11

<sup>34</sup> Commercial Code of Japan, Article 535-542

be higher than equity-based crowdfunding, there are no limitations on both fundraisers and investors, which may be the reason why equity-crowdfunding regulation is not functionalized well.

Table 1: Differences between Equity-based Crowdfunding and Tokumei Kumiai Scheme

	Equity-based Crowdfunding	Tokumei Kumiai (a silent partnership contract)
Platform	10 million JPY or 5 million JPY	10 million JPY or 50 million JPY
Fundraiser	100 million JPY per year	No limitation
Investor	500,000 JPY per year	No limitation

Source: This table is constructed by the author.

#### 2.1.1.2. Equity-crowdfunding in Taiwan

In order to encourage the development of start-ups and small and medium enterprises (hereafter SMEs), the financial authority in Taiwan, which is called Financial Supervisory Commission (FSC), provided a regulatory structure for crowdfunding in May 2015. Since the Security Act in Taiwan requires the high standards for being securities broker<sup>35</sup>, it may be difficult for securities-based crowdfunding platforms attempting to do business in Taiwan. However, the situation may be changed after the new exemption provided by the financial authority in 2015. To know the background of new regulation of crowdfunding in Taiwan, the current multi-level securities market first should be examined since crowdfunding is an innovative way to fill out the gap of fundraising.

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<sup>35</sup> Regulations Governing Securities Firms of Taiwan, Article 9

Fundraising is one of crucial factors for companies operating business in a certain country. In Taiwan, in order to develop a multi-level securities market of diverse products, there are several ways for companies to raise funding in the market. First, a company can do Initial Public Offering in Taiwan Stock Exchange. Second, a company can turn to Taipei Exchange (OTC) for General Stock Board (GSB), and Emerging Stock Board (ESB). The requirements for registering on the ESB are less strict than GSB and Initial Public Offering (IPO) application in Taiwan. Taipei Exchange has also assisted several companies from ESB to GSB and they also assisted them from GSB to IPO. It may be described similar to a staircase for companies raising their funding gradually, corresponding with their business scale.

Third, in January 2014, in order to assist SMEs of non-public companies in Taiwan, Taipei Exchange established a new mechanism, labeled “Incubation Board for Startup and Acceleration Firms (GISA)”. At first glance, it may be viewed as a decent mechanism for SMEs to raise funding much more easily. However, up to April 2015, only 59 companies had successfully met the strict requirements. Moreover, the total amount of GISA is only 199 million TWD (around 6.52 million USD)<sup>36</sup>, which is indicative of diminished success. GISA still cannot supply the capital demand for SMEs in Taiwan. Alternatively, GISA struggles to fill in the gap between capital market and startups.

Following discussions with practitioners, scholars, and government officials, financial authorities in Taiwan provided exemptions for being a securities broker that only focuses on crowdfunding. Therefore, for being securities broker of crowdfunding, the minimum capital

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<sup>36</sup> OTC in Taiwan [證券櫃檯買賣中心], “Current Market of Companies Listing on GISA” [創櫃板公司市場現況], OTC in Taiwan, 證券櫃檯買賣中心, (October 17, 2016).

requirement is 10 million TWD (around 1.6 million USD)<sup>37</sup>, compared with the capital amount of conventional securities broker, which is 50 million TWD (around 6.4 million USD)<sup>38</sup>. This may be easy for crowdfunding platforms to start up their businesses.

Those companies which want to do fundraising on crowdfunding platforms in Taiwan should be: The capital amount of the company is under 30 million TWD (around 0.98 million USD)<sup>39</sup>, and the fundraising on all crowdfunding platforms in Taiwan is under 30 million TWD (around 0.49 million USD)<sup>40</sup>. To protect the right of non-accredited investors, the maximum of per fundraising project is 50,000 TWD (around 1,640 USD)<sup>41</sup>; the maximum of investment in per crowdfunding platform is 100,000 TWD (around 3,281 USD)<sup>42</sup>.

Correspondingly, there are also some restrictions on investment-based crowdfunding in Taiwan. First, the stock issued on crowdfunding platform is limited to be common stock but not preferred stock. Second, it is forbidden to do a general advertisement for certain crowdfunding project on platforms. Third, the secondary market is not allowed for trading the stock issued via crowdfunding. Also the profit models of platforms are limited to procedure fee from issuers and other services fee from issuers and investors.

Although it is a milestone for Taiwan to commence investment crowdfunding to fill the gap within the capital markets, there remain several problems for this new mechanism. First, the cap of

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<sup>37</sup> Regulations Governing Securities Firms of Taiwan, Article 9

<sup>38</sup> Ibid.

<sup>39</sup> Taipei Exchange Regulations Governing the Conduct of Equity Crowdfunding by Securities Firms, Article 19

<sup>40</sup> Taipei Exchange Regulations Governing the Conduct of Equity Crowdfunding by Securities Firms, Article 25

<sup>41</sup> Taipei Exchange Regulations Governing the Conduct of Equity Crowdfunding by Securities Firms, Article 26

<sup>42</sup> Ibid.

the amount for an issuer may be too small. The total amount of issuance of each issuer in one fiscal year must be under 15 million TWD (around 0.49 million USD). This amount may not help many entrepreneurs to start their business.

Second, investors may not be as interested because of the small amount they can invest and the fact that the preferred stock is forbidden under crowdfunding. The investment of startups is always risky, but high risk may lead to high returns. Under the regulations for crowdfunding in Taiwan, even the investors that can afford high risk with their money, the cap amount of investment is limited.

Third, the capital amount of crowdfunding platform is not so flexible. With the development of crowdfunding for several years in the world, there are different business models of crowdfunding. The capital amount of 50 million TWD (around 1.6 million USD) is still too high for certain crowdfunding platforms. It will take some time to examine investment crowdfunding in Taiwan and perhaps amend the regulations once empirical evidence is available.

#### 2.1.2. Summary: Difficulties of Hard-Law on Online Finance

The business model of online innovative finance normally has conflict with financial regulation in most jurisdiction as they are regarded as part of financial services, which traditionally are required licenses and other legal compliances. Accordingly, the industry of online innovative finance has faced difficulties for operating their business legally. Although there is increasing number of financial authorities doing great efforts for providing relevant regulation of allowing the business model of online innovative finance, there still remains a gap between financial authorities and the demand of market.

Generally, there are several obstructions from perspectives of platform, fundraisers, and investors, which could be refined as inflexible minimum or maximum of capital requirement, fundraising capital, and investment. In case study, this Dissertation has picked up equity-crowdfunding regulation in Japan and Taiwan as examples. Some possible shortages could be refined as competition with current regulation, and gap between regulation and social practice, for example, there is already similar regulation in Japan, which is lower cost. Some types of preferred stock are limited in Taiwan, which is not social practice as usual.

Consequently, this study found that because of unique characteristics of online innovative finance, such as high technology and rapid change, it may be difficult to regulate in static way as hard-law. Instead, the ideal regulatory model would be soft-law in dynamic way, which does not need long and complicated procedures for meeting demand of online innovative finance industry.

Table 2: Difficulties of Hard-Law and its Concerns on Online Innovative Finance

	Difficulties of Hard-Law	Concerns
General Overview	Platform	Minimum capital requirement is not suitable as most companies of online innovative finance are startups.
	Fundraisers	Maximum fundraising capital per year is not flexible
	Investors	Maximum investment per year is not flexible as diversified risk tolerance among investors
Case Study	Equity-Crowdfunding in Japan	<ol style="list-style-type: none"> <li>1. There is already similar regulation in practice.</li> <li>2. New regulation is not flexible than original regulation</li> </ol>
	Equity-Crowdfunding in Taiwan	Preferred stock is limited, which is not follow regular practice

Source: This table is constructed by the author.

## 2.2. Soft-Law Perspective: Essence, Legitimacy & Industry Self-Regulation

The soft-law mechanism and its impact on P2P lending in China are fundamental parts of the discussion in this dissertation. Chinese P2P lending is regulated by both hard-law and soft-law measures, for example, the relevant regulation of P2P lending is provided by financial authorities, judicial opinions, and criminal law, which could be regarded as hard-law perspective. Additionally, the industry of P2P lending in China is also influenced by self-regulation organization and credit-rating agencies, which could be categorized as soft-law measures. Hard-law has been practiced and widely discussed for several years without remarkable effect, while soft-law has acquired significance in the initial stage of regulatory scheme. This dissertation tries to explore the soft-law

mechanism in current P2P lending industry in China and how it could work with current hard-law system for enhancing transparency of Chinese P2P lending.

Therefore, how to distinguish the differences between hard-law and soft-law is a necessary issue. Given that soft-law is relatively a recent phenomenon in Chinese P2P lending industry, the soft-law mechanism and its applicable occasion in diversified discipline should be introduced for providing a fundamental base for further discussion.

### 2.2.1. Essence of Soft-Law

Soft-law is defined as “rules that are neither strictly binding nor completely lacking in legal significance<sup>43</sup>” in Black’s Law Dictionary, the concept of soft-law has been widely discussed in many perspectives, such as international law<sup>44</sup>, constitutional law<sup>45</sup>, and administrative law<sup>46</sup>. With growing numbers of articles debated, the coverage of soft-law also extended to environmental law<sup>47</sup>, accounting and audit<sup>48</sup>, and so forth. Based on this viewpoint, the idea of soft-law has been broadly covered with diversified legal subjects. Some literatures have simply regarded soft-law as non-hard

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<sup>43</sup> “Soft Law,” *Black’s Law Dictionary*, 2009. “1. Collectively, rules that are neither strictly binding nor completely lacking in legal significance. 2. Int’l law. Guidelines, policy declarations, or codes of conduct that set standards of conduct but are not legally binding.”

<sup>44</sup> Kenneth W. Abbott and Duncan Snidal, “Hard and Soft Law in International Governance,” *International Organization* 54, no. 3 (2000): 421–456.

<sup>45</sup> Lorne Sossin, “Discretion Unbound: Reconciling the Charter and Soft Law,” *Canadian Public Administration* 45 (2002): 465–489.

<sup>46</sup> Lorne Sossin and Charles W. Smith, “Hard Choices and Soft Law: Ethical Codes, Policy Guidelines and the Role of the Courts in Regulating Government,” *Alberta L. Rev.* 40 (2003): 867.

<sup>47</sup> Pierre-Marie Dupuy, “Soft Law and the International Law of the Environment,” *Mich. J. Int’l L.* 12 (1990): 420–35.

<sup>48</sup> Kazuaki Kagami (加賀見一彰), “The Secondary Rule of Soft-Law – Economic Perspective of Accounting and Audit” [ソフトローの Secondary Rule への経済学的視点—会計および監査制度を題材に], *Soft-Law Research* [ソフトロー研究], no. 2 (March 2005): 113–136.

law<sup>49</sup>, while others have pointed out the definition “non-hard law” may not be exact coverage of soft-law and tried to portrait soft-law by listing its characteristics from different viewpoints<sup>50</sup>.

This research is not trying to propose definition of soft law. Instead, this study tries to show diversified definition of soft-law, which may indicate that characteristics of soft-law are verified due to factors of its discussed context. Specifically, in discussion of international law, hard-law may generally refer to treaties and soft-law may be declaration as “Declaration of the Rights of Man and of the Citizen”. However, in argument of administrative law, hard-law may normally refer to legislative regulation and soft-law may be administrative guidelines. Moreover, the subjects of international law are usually cover nations and international organizations and the subjects of administrative law are focusing on citizens and government. In this regard, the definition and border between hard-law and soft-law are also verified.

Consequently, this Dissertation found there are several important characteristics of soft-law definition, which includes (1) universality: it has been widely defined from different perspectives, (2) variability: it verifies based on discussed context, and (3) uncertainty: there is no universal definition. One may argue that there is already clear definition based on “binding effect” as Black’s Law Dictionary. Nonetheless, it may be difficult to explain “substantial binding effect<sup>51</sup>” of soft-law in some cases. Though there is also definition as “enforced by government<sup>52</sup>”, there still remains

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<sup>49</sup> Ibid.

<sup>50</sup> Jacob E. Gersen and Eric A. Posner, “Soft Law: Lessons from Congressional Practice,” *Stanford Law Review*, 2008, 582–86.

<sup>51</sup> “...it is revealing that soft law may come in so many forms. Rules, manuals, directives, codes, guidelines, memoranda, correspondence, circulars, protocols, bulletins, employee handbooks and training materials all may have a substantial influence...” Sossin and Smith, “Hard Choices and Soft Law,” 871.

<sup>52</sup> Nakayama, *The Theory of Soft-Law*, 3.

questions, for example, hortatory statutes<sup>53</sup> are passed by congress but lack of enforcement by government. Hence, this study not deny efforts of these definitions. Instead, this article tries to show that soft-law is hard to define universally.

Table 3: Overview of Soft-Law

Current Definition	1. Rules that are neither strictly binding nor completely lacking in legal significance 2. Enforced by government
Major Discussed Context	International law, constitutional law, administrative law, environmental law, accounting and audit, finance law, and so forth.
Remarks of Finding	Characteristics of Soft-Law Definition (1) universality: it has been widely defined from different perspectives; (2) variability: it verifies based on discussed context; and (3) uncertainty: there is no universal definition.
Concluding Remarks	Soft-law is hard to define universally. Hence, this research found that it is important to have discussion of exploring soft-law on online innovative finance, the broad idea of P2P lending, another new perspective of soft-law.

Source: This table is constructed by the author.

This Dissertation also found that typical discussion of soft-law could be categorized as (1) cost effectiveness: this type of articles<sup>54</sup> have normally pointed out that the legal cost of soft-law is lower than hard-law, which explains the importance and necessity of soft-law; (2) enforcement power:

<sup>53</sup> hortatory statute. Gersen and Posner, "Soft Law," 584.

<sup>54</sup> Ibid. at 576.

scholars<sup>55</sup> advocate that soft-law is flexible but lack of enforcement power as hard-law, which shows the weakness of soft-law; (3) substantial binding effect: some researches<sup>56</sup> indicate that although soft-law has no enforcement power, there is substantial binding effect in practice. It is dangerous if there are no proper procedures of due process; (4) object of litigation: based on previous discussion, the literature<sup>57</sup> has discussed whether it is possible to file a litigation against soft-law or not; and (5) interactive dialogue style of legislation: this scholarship<sup>58</sup> suggests that soft-law could work as quasi-law for hard-law preparation. Proposed categories do not tried to cover whole academic discussion but show part of mainstream discussion for understanding soft-law.

Following above discussion, at first glance, this study found that there remains conflict between scholarship of (1) enforcement power and (2) substantial binding effect. On one hand, some scholars suggest that soft-law lack enforcement power. On the other hand, others argue that soft-law has substantial power but there is low involvement of supervision. It is evitable that two scholarship advocating their viewpoints in contrast. Nevertheless, this may be caused by different context of their case study of soft-law, for example, the argument of lack of enforcement power may be indicated in international law aspect that soft-law is not as strong power as treaties and administrative guidelines have substantial power without supervision from legislative power.

With this finding, concluding remarks of certain soft-law case study may not be easy to implement to another context. Specifically, the discussion of soft-law is normally under a unique case study, which may not show its reproducibility in other cases. Although there is no common

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<sup>55</sup> Anna Di Robilant, "Genealogies of Soft Law," *American Journal of Comparative Law*, 2006, 508.

<sup>56</sup> Sossin and Smith, "Hard Choices and Soft Law," 871.

<sup>57</sup> Ibid. at 888–90.

<sup>58</sup> B. M. J. Klink and W. J. Witteveen, "Why Is Soft Law Really Law?," *RegelMaat*, March 1999, 127–28.

viewpoints of soft-law based on literature review, with above literature reviews and discussion, it is useful to understand how to analyze a new issue of soft-law in diversified disciplines by different approaches.

Table 4: General Discussion of Soft-Law and its Conflicts

General Discussion of Soft-Law	<ol style="list-style-type: none"> <li>1. Cost effectiveness</li> <li>2. Enforcement power</li> <li>3. Substantial binding effect</li> <li>4. Object of litigation</li> <li>5. Interactive dialogue style of legislation</li> </ol>
Conflict and its Reasons between Scholarships	<p>Q: Does scholarships of suggesting soft-law is lack of enforcement power and advocating that soft-law has substantial binding effect are conflict and not logical?</p> <p>A: The discussions of these two scholarships are under different scenario and context, which may not compare and implement one's concluding remarks directly.</p>
Concluding Remarks	<p>The discussion of soft-law is normally under a unique case study, which may not show its reproducibility in other case. It is important to have discussion of exploring soft-law on online innovative finance, another new perspective of soft-law.</p>

Source: This table is constructed by the author.

### 2.2.2. Merits and Demerits between Hard-Law and Soft-Law

In previous section, this research has tried to define the border between hard-law and soft-law in different perspectives. However, this study has found that the relation between hard-law and soft-law

may be complement to some extent. The literature<sup>59</sup> has suggested that although soft-law has its advantages of effectiveness and flexibility, it may be more effective with combination of hard-law.

Despite that the many diversified discussions of soft-law, this Dissertation will only focus on perspectives of cost effectiveness, enforcement power, and substantial binding effect for distinguishing unique characteristics between hard-law and soft-law. Specifically, this study regards two other approaches of soft-law, object of litigation and interactive dialogue style of legislation, as non-fundamental units. In other words, object of litigation may be extended discussion of substantial binding effect. And interactive dialogue style of legislation may be another way of cost effectiveness discussion.

#### 2.2.2.1. Perspective of Cost Effectiveness

There are a couple of discussions regarding soft law and its cost effectiveness, which may show its difference with hard-law. In administrative law, the literature<sup>62</sup> has indicated that administrative agencies tend to commit their policy by adopting informal and non-binding guideline for preventing costs caused by legal procedures and have substantial effect in practical. In addition, the literature pointed out that administrative agencies sometimes have “best practices” for suggesting regulated object following their opinions<sup>63</sup> in the United States, which show soft-law and its flexibility for administrative agencies.

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<sup>59</sup> Di Robilant, “Genealogies of Soft Law,” 225.

<sup>62</sup> John F. Manning, “Nonlegislative Rules,” *Geo. Wash. L. Rev.* 72 (2004): 914–15.

<sup>63</sup> David T. Zaring, *Best Practices*, Rochester, NY, SSRN Scholarly Paper ID 899149 (Social Science Research Network, April 27, 2006), 307–13.

Except of administrative law discussion, there are also other perspectives. In the case study of soft-law and its effect on congress<sup>64</sup>, the literature has suggested that soft-law could also realize same effect as hard-law in lower cost. Furthermore, the study of congress and soft-law also indicated that soft-law could raise up more discussion of its pros and cons<sup>65</sup>. In accounting and audit perspective<sup>66</sup>, the scholar has pointed out that soft-law is beneficial to audit procedures as they could amend their rules without gaining cost. Moreover, this study also further noted that it may be dangerous to try making soft-law to become hard-law, which may lose this characteristic.

In other words, soft-law could work as alternative choice of hard-law with low cost as it does not require complicated legal procedures. Meanwhile, as soft-law is much more flexible, the possibility of discussion and amendment are relatively easy to commit. From the perspective of cost effectiveness, the literature has tried to answer why administrative agencies adopt soft-law in practical; is soft-law more economic than hard-law; and what benefits of implementing soft-law. Namely, soft-law is relatively flexible and lower cost than hard-law.

#### 2.2.2.2. Enforcement Power and Substantial Binding Effect

Soft-law has normally been criticized that it is lack of enforcement power<sup>67</sup>. It is evitable that the binding effect of hard-law is stronger than soft-law in general<sup>68</sup>. In contrast to above arguments, under discussion of codes of ethics and policy guidelines, the literature has indicated that soft-law has its substantial binding effect, "...Soft law cannot in theory bind decision-makers, yet in practice

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<sup>64</sup> Gersen and Posner, "Soft Law," 594.

<sup>65</sup> Ibid. at 594–95.

<sup>66</sup> Kazuaki, "The Secondary Rule of Soft-Law – Economic Perspective of Accounting and Audit."

<sup>67</sup> Di Robilant, "Genealogies of Soft Law," 225.

<sup>68</sup> Gersen and Posner, "Soft Law," 597.

it often has as much or more influence than legislative standards<sup>69</sup>...” Nonetheless, in previous paragraph, researches have suggested that soft-law is lack of enforcement power. The literature also further indicated that soft-law is redundant and harmful<sup>70</sup>. Although it is easy to understand that enforcement power may refer to government’s enforcement and substantial binding effect is without statute law, it still remains question why study need to have this classification if they have same effect in the end.

In order to answer above question, it is important to understand the issue why administrative agencies adopt soft-law and its difference with hard-law. This issue actually has been addressed in previously, which shows cost effectiveness of soft-law. Because legislative procedures for new policy by administrative agencies<sup>71</sup> is normally time consuming, soft-law may be a better choice than hard-law. However, if there is no enforcement power, administrative agencies also may not prefer it. Namely, soft-law should have substantial binding effect which administrative agencies having incentives to adopt it rather than hard-law. With the characteristic of substantial binding effect, soft-law is criticized because there is no enough legal base for support<sup>72</sup>. Moreover, there may not have any remedies of soft-law.

Specifically, soft-law has substantial binding effect but lack of public scrutiny as hard-law, such as parliamentary debate, public hearings, notice and comment requirements, and judicial review<sup>73</sup>. The literature<sup>74</sup> also has raised some cases that courts have void administrative guidelines

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<sup>69</sup> Sossin and Smith, “Hard Choices and Soft Law,” 869.

<sup>70</sup> Jan Klabbers, “The Undesirability of Soft Law,” *Nordic Journal of International Law* 67 (1998): 382–83.

<sup>71</sup> Gersen and Posner, “Soft Law,” 594–95.

<sup>72</sup> *Ibid.* at 594.

<sup>73</sup> Sossin and Smith, “Hard Choices and Soft Law,” 869.

<sup>74</sup> *Ibid.* at 888–89.

as they have conflict with statute law, which may be regarded as a violation of the separation of powers. Another example may refer to transformation of administrative guidelines in Japan before and after the Administrative Procedure Act enacted<sup>76</sup>. Administrative guidance<sup>77</sup> has been widely practiced in many perspectives in Japan<sup>78</sup>, which show its substantial binding effect of soft-law. Several problems<sup>79</sup> have been pointed out, including (1) substantial binding effect, (2) working as legal loophole for avoiding legal procedure, (3) liability is vague, and (4) lack of remedies. However, after Administrative Procedure Act was enacted, there are many requirements of issuing administrative guidance for pursuing due process<sup>80</sup>. Therefore, due process is accompanied with substantial binding effect of soft-law. In this regard, the difference between hard-law and soft-law is the different levels of their due process.

#### 2.2.2.3. Summary

In the beginning of this part, this research found that the characteristics of soft-law definitions could be refer to universality, variability, and uncertainty, which are difficult to have a common definition. This Dissertation follows this finding and further review current literature of soft-law for understanding how to conduct an analysis of soft-law in new case study. This study tried to clarify differences between hard-law and soft-law by three major perspectives including cost effectiveness,

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<sup>76</sup> Lorenz Kodderitzsch, "Japan's New Administrative Procedure Law: Reasons for Its Enactment and Likely Implications," *Law Japan* 24 (1991): 105.

<sup>77</sup> Administrative Procedure Act of Japan, Article 2 (vi) Administrative Guidance: guidance, recommendations, advice, or other acts by which an Administrative Organ may seek, within the scope of its duties or affairs under its jurisdiction, certain action or inaction on the part of specified persons in order to realize administrative aims, where such acts are not Dispositions.

<sup>78</sup> Sato Hidetake (佐藤英善), *The Economic Administrative Law* [経済行政法] (Tokyo: Seibundo, 1990), 934–36.

<sup>79</sup> *Ibid.* at 943–44.

<sup>80</sup> Administrative Procedure Act of Japan, Article 34-36

enforcement power and substantial binding effect. This research has found that several characteristics of soft-law, which includes preventing complicated legal procedures, integrating different opinions, efficient amendment, possibility of violation of the separation of powers, and possibility of lack of due process.

Table 5: Part Differences of Hard-Law and Soft-Law

Differences	Subjects	Arguments
Perspective of Cost Effectiveness	Administrative Law	Prevent Complicated Legal Procedures: Non-binding guideline for preventing costs caused by legal procedures
	Legislative Technique	Integrating Different Opinions: Soft-law could raise up more discussion of its pros and cons
	Accounting and Audit	Efficient Amendment: Soft-law is beneficial to audit procedures as they could amend their rules without gaining cost
Enforcement Power and Substantial Binding Effect	Constitutional Law	Possibility of Violation of Separation of Power: A violation of the separation of powers may be caused by conflict between administrative guidelines and statute law
	Administrative Law	Possibility of Lack of Due Process: The concept of due process should be emphasized and accompanied with substantial binding effect of soft-law

Source: This table is constructed by the author.

Although there are already numbers of literatures doing research of soft-law, it still remains diversified concluding remarks due to its different scenario. Therefore, it is valuable to do a study for understanding online finance innovation and its relationship with soft-law. In order to understand the soft-law roles of industry association and CRAs on P2P lending in China, which are regarded as two major institutions of soft-law in this dissertation, it is necessary to analyze its mechanism, advantages, and disadvantages from a general perspective in the following section.

### 2.2.3.Example of Soft-Law: Industry Self-Regulation

The mechanism of self-regulation has been practiced in many aspects, for example, the concept of self-regulation may indicate personal self-regulation but also industry self-regulation, which has wide coverage of objects. In this Dissertation, the scope of self-regulation is focusing on industry self-regulation, which has been regarded as supplemental mechanism of government regulations<sup>81</sup>, especially when government policies are not so effective. According to a report published by OECD<sup>82</sup>, the scope of industry self-regulation may be defined as “industry self-regulation concerns groups of firms in a particular industry or entire industry sectors that agree to act in prescribed ways, according to a set of rules or principles. Participation by firms in the groups is often voluntary, but could also be legally required”, which include three elements, group of firms, a set of rules of principles agreed by a group, and voluntarily organized.

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<sup>81</sup> *Industry Self-Regulation: Role and Use in Supporting Consumer Interests*, no. JT03372908, (Organisation for Economic Co-operation and Development, March 23, 2015).

<sup>82</sup> Ibid.

In addition, the concept of self-regulation is different from deregulation<sup>83</sup>. Despite the fact that a mechanism of self-regulation develops its own rules as obligations of their members, it still should be taken as a supplemental tool of government regulation rather than deregulation. One may question that government regulation has already taken measures toward a certain industry, self-regulation may be overlapped with power of government and existed regulation. Hence, the above issue is normally doubted in terms of considering implementation of self-regulation. Nevertheless, rules designed by practitioners with specified knowledge of an industry self-regulation entity is more practical than policy maker in government sector<sup>84</sup>, which make rules more applicable to an industry in theory.

Although some advantages of industry self-regulation have been raised in theory, there still remained some criticism from several aspects, for example, an entity of industry self-regulation is normally criticized for mostly serving their industry rather than the public interest<sup>85</sup>, which is shown as . Further, the abuse of power by an industry self-regulation entity remains a concern as well<sup>86</sup>. From this point of view, some general proponents and critics have shown that there are remaining gaps among different entities of industry self-regulation in practice. Because of diversified background of social and economic context, the effectiveness and accountability will also be influenced variably as well<sup>87</sup>. In order to understand and analyze the above issue, advantages and challenges of industry self-regulation will be discussed.

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<sup>83</sup> Neil Gunningham and Joseph Rees, "Industry Self-Regulation: An Institutional Perspective," *Law & Policy* 19, no. 4 (1997): 396.

<sup>84</sup> Gunningham and Rees, "Industry Self-Regulation."

<sup>85</sup> Ibid.

<sup>86</sup> Anthony Ogus, "Rethinking Self-Regulation," *Oxford Journal of Legal Studies* 15 (1995): 98–99.

<sup>87</sup> Gunningham and Rees, "Industry Self-Regulation," 370.

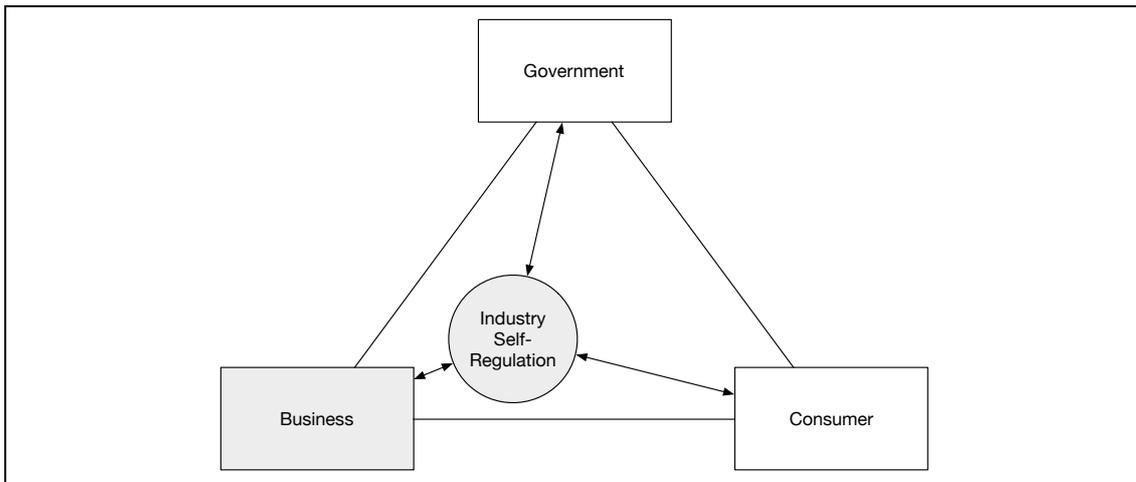


Figure 3: Disequilibrium of Self-Regulation Model

Source: The figure is constructed by author

#### 2.2.3.1. Advantages and Challenges

As previous part mentioned, an entity of industry self-regulation is organized by firms in a certain industry. However, the effects of decision made by an industry self-regulation entity are not only influenced its members but also other stakeholders in a market. The overview of stakeholders in a market could cover three main players in terms of a general view, which include government, business, and consumer, which may show that the mechanism of self-regulation may be regarded and work as an agency among all players of a market. Namely, one of crucial responsibilities of industry self-regulation is fairly and properly distribute benefits to each party. From this view point, how to strike a balance among stakeholders is a critical issue that an entity of industry self-regulation may face and conquer. As a result, this study introduced some advantages and challenges of the above three players for understanding factors should be emphasized and aware by an entity of industry self-regulation in general based on literature reviews.

Some advantages of industry self-regulation has been indicated on Table 6. There are many advantages written in different literature. In general, speed, flexibility, sensitivity to market circumstances and lower costs have been regarded as main factors<sup>88</sup>. This research has refined some advantages as follows: government may be benefited from industry self-regulation when they do not have enough power or insufficient understanding of an industry, which self-regulation may work as supplemental role of an invisible hand of a market; consumer may share advantages on (1) access of information has been enhanced, (2) the channel of dispute resolution has been established, (3) the right of consumer has been emphasized; business of an industry may also take advantages on (1) reputation of an industry has been promoted, (2) the channel of dispute resolution with customers has been established, and (3) the negotiation power with government has been strengthened. This relation may be regarded as equilibrium among business, government, and consumer in terms of industry self-regulation.

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<sup>88</sup> Ibid. at 366.

Table 6: Advantages of Industry Self-Regulation

Stakeholders	Advantages from Industry Self-Regulation <sup>89</sup>
Government	Strengthen limited power on an industry
Consumers	Improved information
	More effective dispute resolution
	Combatting unfair or abusive practices
	Enhanced consumer rights
Industry	Enhancing consumer confidence/ improving the image of business
	Disciplining business that fail to meet commitments
	Improving complaint handling
	Pre-empting formal government regulation
	Providing instructional resources

Source: This table is constructed by the author.

Although some advantages are beneficial to government, consumer, and business under industry self-regulation, there are still some challenges for establishing and maintaining a functionalized industry self-regulation entity, for example, relevant rules made of industry self-regulation system may not be implemented due to lack of effective enforcement power<sup>90</sup>. Another example is that the market coverage of an entity of industry self-regulation may be low. As shown in Table 7, there are still some challenges that should be emphasized. Nonetheless, most of challenges are caused by either an entity of self-regulation or industry. In this viewpoint, although there are still government and consumer as stakeholders of market and share benefits from industry self-regulation, the key factors of conquering challenges are still necessary to be solved by industry and association themselves.

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<sup>89</sup> “Industry Self-Regulation: Role and Use in Supporting Consumer Interests.”

<sup>90</sup> Ibid.

Table 7: Challenges of Industry Self-Regulation

Challenges from Industry Self-Regulation <sup>91</sup>	Caused by	
	Association	Industry
Strength of instruments	V	V
Compliance and oversight	V	V
Risk of regulatory capture	V	V
Free-riders		V
Market coverage	V	V
Favoritism	V	V
Distortions in competition	V	V
Accountability	V	
Costs	V	

Source: This table is constructed by the author.

#### 2.2.3.2. Summary

In this part, as shown in Table 8, this Dissertation tries to introduce the theory of self-regulation, especially industry self-regulation, which includes three main compositions: a group of firms, a set of rules of principles agreed by a group, and voluntarily organized in somehow. Based on literature review, this study clarifies borders among regulation, deregulation, and self-regulation, which shows that self-regulation is also a subsidiary concept of regulation and supports government regulation.

In addition, rules designed by industry self-regulation is normally more applicable to an industry than government sector in theory. Nonetheless, it is also criticized that an entity of industry self-regulation sometimes tends to protect benefits of their industry rather than considering others benefits. Further, this research also indicates that advantages generated by an entity of industry self-

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<sup>91</sup> Ibid.

regulation will be shared by industry, government, and consumer, which shows external factors of this mechanism. Challenges of an entity of industry is mostly caused by entity or industry themselves, which shows its internal factors. Consequently, it is evitable that above external and internal factors could be taken as some crucial indicators analyzing research certain industry self-regulation.

In Chapter 3, Peer-to-Peer Finance Association (P2PFA) is taken as a case study for implementing an analysis with the above mentioned internal and external indicators. As pure self-regulation is rarely happened in practice<sup>92</sup>, this Dissertation found that P2PFA successfully organized by private sectors and established a high standard as obligation of their members, which may be one of successful factors making prosperity of P2P lending business in the UK. As a result, this study tries to base on aforementioned theories and some standards for measuring the key factors of effectiveness in P2PFA.

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<sup>92</sup> Gunningham and Rees, "Industry Self-Regulation," 366.

Table 8: The Brief Overview of Industry Self-Regulation

Definition	<ol style="list-style-type: none"> <li>1. a group of firms</li> <li>2. a set of rules of principles agreed by a group</li> <li>3. voluntarily organized in somehow</li> </ol>	
Clarity	Industry self-regulation is also subsidiary concept of regulation, supporting government regulation rather than deregulation.	
External Factors	Government	Strengthen limited power on an industry
	Consumer	<ol style="list-style-type: none"> <li>1. Improved information</li> <li>2. More effective dispute resolution</li> <li>3. Combating unfair or abusive practices</li> <li>4. Enhanced consumer rights</li> </ol>
	Industry	<ol style="list-style-type: none"> <li>1. Enhancing consumer confidence/ improving the image of business</li> <li>2. Disciplining business that fail to meet commitments</li> <li>3. Improving complaint handling</li> <li>4. Pre-empting formal government regulation</li> <li>5. Providing instructional resources</li> </ol>
Internal Factors	Association	An entity of industry self-regulation sometimes tends to protecting benefits of their industry rather than considering others benefits.
	Industry	

Source: This table is constructed by the author.

#### 2.2.4.Example of Soft-Law: Credit Rating Agency

CRA's, such as Moody's Investor Service, Standard & Poor's, and Fitch Rating, after development of a century, have emerged as an indispensable part of global and local financial markets which provide investors critical references of making their investment decision. The first well-known credit rating report, which provides a series of analysis of railroad debt market in the

United States in 1909, was published by John Moody<sup>93</sup>. He has then established Moody's Investor Service in 1916. Another two well-known CRAs, Standard Statistics Company and Fitch Publishing Company had been founded in 1922 and 1924. By credit rating report published by CRAs, from the perspective of investors, the business could easily be understood through alphabetical or other form ranking system, for instance, AA, AAa, AA+, and other forms for ranking. From the perspective of rated companies, it is critical for them to improve their ranking for attracting potential investors to raise capital.

There are roughly two major drivers of CRAs. First, from the demand of investors, as the market is lack of transparency and it is not economical for an investors collect relevant information for making investment decision by himself, scale economy provided by CRAs is necessary. Second, from the demand of a rated company, as a huge gap remains among transaction market, a company need to be evaluated for attracting potential investment. With trust on CRAs growing from both investors and rated companies, the reputation of a CRA is established. The reputation is core value of a CRA. Without reputation, a CRA could not supply the demand of investors and a rated company will not try to improve for meeting requirement of a CRA as investors do not take it as reference for investment.

Credit rating report has emerged as an important aspect of P2P lending industry in China. It is a featured phenomenon of Chinese P2P lending market, which does not show similar characteristics in practice of other P2P lending industries in the world, especially compared with leading markets, such as the United States and the United Kingdom. The impact of credit rating reports of P2P

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<sup>93</sup> Mohammed Hemraj, *Credit Rating Agencies: Self-Regulation, Statutory Regulation and Case Law Regulation in the United States and European Union* (Springer, 2015), 30–31.

lending in China have gradually acquired significance over the last few years. There are at least six leading credit rating reports<sup>94</sup> regularly published in P2P lending market, which provides investors alternative references of making decision for their P2P lending investment.

#### 2.2.4.1. Advantages and Challenges

Compared with the soft-law role of industry association established by industry, a CRA, as a third part institution, is more neutral and fair because of its independence. An industry association is constituted by industry members and provides regulations by themselves and they tend to maximize their benefits without consideration of public interest as well as exclude new competitors. Hence, the issues of self-interest and anti-competition are natural phenomenon of an industry association. In contrast, a CRA is not constituted by industry. Therefore, the neutrality of CRAs is more expectable than an industry association. Compared with Figure 4, the structure of Figure 5 shows that industry association and a CRA are different, which has impact on their independence.

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<sup>94</sup> Chinese Academy of Social Sciences, Dagong Credit, P2P Eye, Rong 360, Wangdaizhijia, YiFei

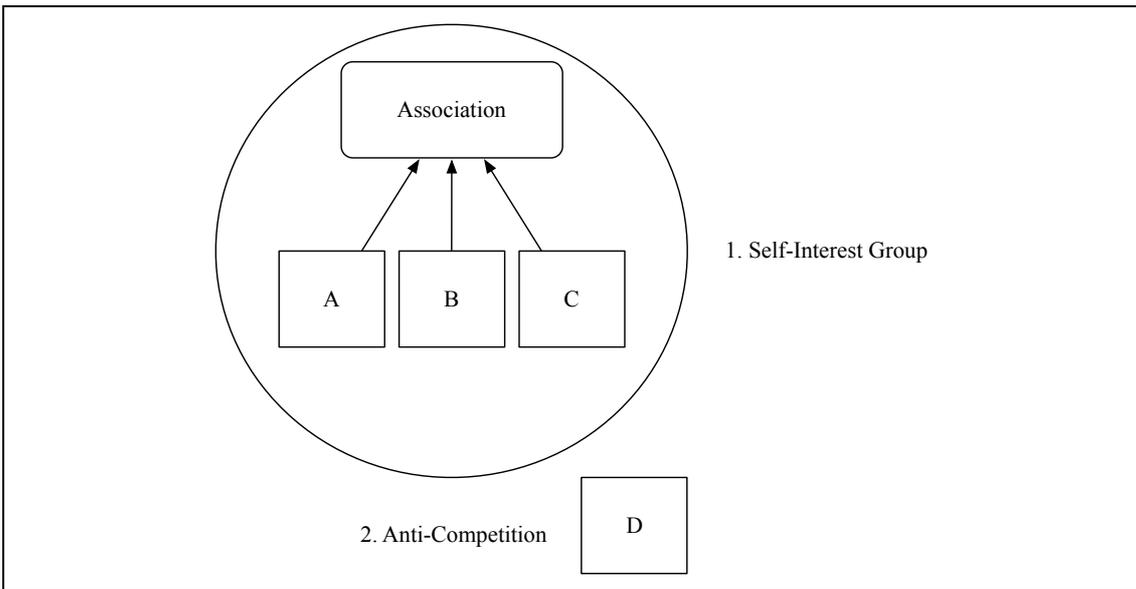


Figure 4: Structures of Industry Association

Source: The figure is constructed by author

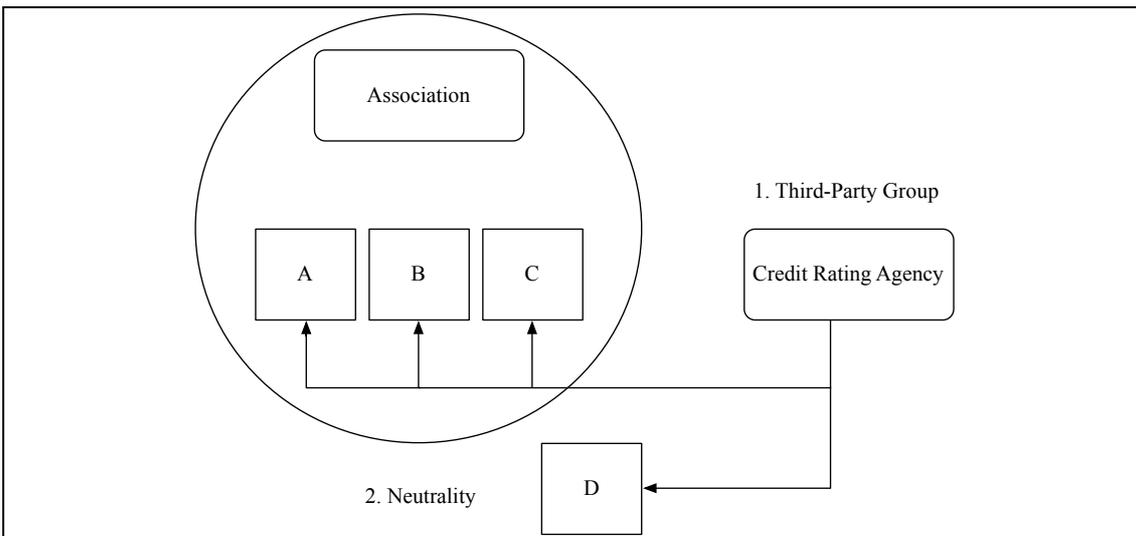


Figure 5: Structures between Industry Association and Credit Rating Agency

Source: The figure is constructed by author

CRA's in the United States gradually acquired significance after the great depression in 1930s as they successfully detected potentials risks. Nonetheless, the relevant regulation was introduced in

1970s as the default caused by Penn Central Railroad was not detected by major CRAs<sup>95</sup>.

Additionally, CRAs have regarded as one of major reasons caused financial crisis in 2008. On the one hand, CRAs may provide correct information to enhance market transparency. But on the other hand, CRAs may also provide wrong information to reduce market transparency.

The business model of CRAs could be roughly divided into investor-pay model (subscription model) and issuer-pay model<sup>96</sup>. Prior to 1970s, the business model of CRAs was investor-pay model, which means that credit rating report was a subscription service. Nevertheless, with widespread of photocopier in 1970s, the rating report issued by CRAs was easily to remake illegally by photocopier at low cost. The three major CRAs, Moody's, S&P, and Fitch had changed their business model to issuer-pay model in 1970s. Specifically, their profit is normally generated from rated companies.

However, the issuer-pay model has been criticized a lot for a few decades until now as the interest conflict between issuer and rating companies could not be easily solved, for instance, CRAs may charge a rated company "advisory fee". Specifically, rating companies should provide fair rating report of a rated company to general public. However, the profit of rating services is mostly generated from a rated company. Under above situation, it is difficult to prevent corruption between a CRA and a rated company as they could easily work together for providing false information and mislead the decision made by investors.

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<sup>95</sup> Richard M. Levich, Giovanni Majnoni, and Carmen Reinhart, *Ratings, Rating Agencies and the Global Financial System* (Springer Science & Business Media, 2012), 47.

<sup>96</sup> Herwig Langohr and Patricia Langohr, *The Rating Agencies and Their Credit Ratings: What They Are, How They Work, and Why They Are Relevant* (John Wiley & Sons, 2010), 411–17.

#### 2.2.4.2. Summary

This part focuses on the role of CRAs that occupy a potentially critical and visible position in Chinese P2P lending industry. By issuing credit rating reports to provide P2P lending investors a reference for making investment decision, various CRAs have emerged to perform regulatory functions to improve market transparency of diverse P2P lending platforms, and, perhaps more importantly, their efficiency possibly extends beyond the industry association and the state agency. CRAs have unique features enabling them to serve important social aims that neither the industry association nor the government can adequately fulfill. Nonetheless, scholars have tended to overlook CRAs as a topic worthy of theorizing and empirical investigation. Given the importance of CRAs in the P2P lending industry, it is surprising how little attention they have received in legal literature.

#### 2.3. Co-Regulation Perspective: Mixture of Hard-Law and Soft-Law

In previous part, this research has tried to define border between hard-law and soft-law in different perspectives. Nonetheless, we have found that the relation between hard-law and soft-law may be complementation to some extent. The literature<sup>97</sup> suggested that although soft-law has its advantages of effectiveness and flexibility, it may be more effective with combination of hard-law. It has further indicated that “some hard law is to secure a regulatory bottom-line below which soft law may not fall<sup>98</sup>” and “soft standards and guidelines complement a base of binding hard norms securing rights and determining fundamental policy directions<sup>99</sup>” Based on this viewpoint, this Dissertation found that it may not be really important to clarify the border between hard-law and

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<sup>97</sup> Di Robilant, “Genealogies of Soft Law,” 225.

<sup>98</sup> Ibid.

<sup>99</sup> Ibid.

soft-law as they are regarded as complementation and implemented at the same time. In other words, it is also necessary to discuss how to combine hard-law and soft-law for eliminating their own demerit and maximizing their merits.

The concept of co-regulation is developed to achieve aforementioned goals. According to the report published by OECD<sup>100</sup>, “Under co-regulation the regulatory role is shared between government and industry...It also exploits the expertise and knowledge held within the industry or professional association...Co-regulation affords government the opportunity to involve industry and interested parties in the investigation and enforcement of the regulations...” From the above statement, the regulatory body of co-regulation is constituted by both government and industry. Moreover, the expertise and knowledge of industry association are utilized by government for enhancing both investigation and enforcement of their policies or regulations. Nonetheless, the report<sup>101</sup> also indicates that “there is a substantial risk...become the vehicle for anti-competitive activities created by the industry regulators...” In other words, regulatory barriers caused by industry association should be aware in the discussion of co-regulation model.

Nonetheless, the co-regulation model provided by OECD focuses on collaboration between government and industry association merely rather than government and third party institution, such as credit-rating agencies addressed in previous paragraph. In order to strengthen regulatory power among members, the regulatory subject of industry association tends to be single without competition. In contrast, the regulatory subject of CRAs tends to be multi with competition because its regulatory power is from outside rather than inside as industry association. Accordingly, the

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<sup>100</sup> OECD, *Regulatory Policies in OECD Countries* (Paris: Organisation for Economic Co-operation and Development, 2002), 137.

<sup>101</sup> Ibid.

discussion of industry association is how to prevent its anti-competition statuses and the discussion of CRAs is how to enhance competition of several CRAs for preventing monopolies. Therefore, there are two important roles from the perspective of government. First, how to include industry for achieving co-regulation. Second, how to reduce side-effects caused by industry, such as anti-competition caused by rules provided by industry association and misusing discourse power by third party institutions, such as CRAs.

#### 2.4. Analysis and Reflection

In this Chapter, in order to understand its definition and relevant discussions, this study firstly introduces theories of soft-law. Though there remains disputes of definition of soft-law, through literature reviews, this research has found that it may cause by diversified discussed context among literatures. Specifically, subjects and objects of each discussion are verified, for example, the discussion between soft-law and hard-law generally compared treaties and declaration among international organizations and nations in international law aspect. However, the discussion may focus on statute law and administrative guidelines among government and citizens in administrative law perspective.

And the border between soft-law and hard-law could also be verified because of the research approach, such as perspective of cost effectiveness, enforcement power, substantial binding effect, object of litigation, and interactive dialogue style of legislation. Based on above observation, this Dissertation has found that there are some characteristics among literature reviews of soft-law, including universality: soft-law has been widely defined from different perspectives; variability: soft-law is verified based on discussed context; and uncertainty: there is no universal definition of

soft-law. Through literature reviews, there are two aspects of soft-law that should be explored in this study, including cost effectiveness and substantial binding effect, as limited research scope. Firstly, it is important to compare effectiveness between hard-law and soft-law for understanding whether it is necessary to introduce soft-law as an auxiliary measure to current regulation or policy. Secondly, substantial binding effect should be highlighted in soft-law practice as it is relatively lack of due process and remedies, compared with hard-law.

Therefore, this research further addressed the issue for examining difficulties of hard-law on online innovative finance for figuring out whether it is necessary to introduce soft-law based on cost effectiveness analysis of hard-law. As P2P lending is a subsidiary concept of online innovative finance industry, it is useful to overview characteristics from a broad overview. This Dissertation found that the regulation of online innovative finance is relative static for this industry as the business model of online innovative finance with rapid change. It is hard to provide appropriate maximum or minimum amount limitation for excluding platforms, supervising fundraisers, and protecting investors as they are diversified groups rather than traditional finance industry.

Additionally, based on case study of equity-crowdfunding in Japan and Taiwan, this study has found above remarks have been shown in these cases. This research also further found that difficulties of hard-law on Chinese P2P lending market as there are thousands of P2P lending platforms, which is hard to exclude by static regulation as it will cause damages to wide coverage of investors. Dynamic regulation, as soft-law or co-regulation are needed.

Therefore, this chapter mainly focuses on cost effectiveness of hard-law on online innovative finance and P2P lending in China. Based on findings, this Dissertation indicated that only hard-law

is not effective for this industry. Soft-law should also take into consideration for comprehensive perspective regulation.

The origin of P2P lending, Zopa, founded in 2005 in the UK, which has become a leading model in the world after several years of development. Since the global financial crisis in 2008, individuals and small companies have difficulty getting credit from banks<sup>102</sup>. As a result, there are increasing numbers of P2P lending platforms in the world to supply for strong capital demand of market.

According to the reports published through Cambridge Centre for Alternative Finance, University of Cambridge<sup>103</sup>, the top three countries of P2P lending are China, the United States, and the United Kingdom in terms of transaction amount. Given that the industry of P2P lending in the United States is mainly regulated by SEC rather than soft-law mechanism, this chapter focuses on comparative study of development and regulatory framework of P2P lending between the UK and China. Specifically, this chapter analyzes on how P2P lending is co-regulated by hard-law and soft-law in the UK. Furthermore, this study also examines whether it is possible to implement aforementioned model into China through analysis of economical, hard-law, soft-law, and co-regulation perspectives.

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<sup>102</sup> Gert Wehinger, “SMEs and the Credit Crunch: Current Financing Difficulties, Policy Measures and a Review of Literature,” *OECD Journal: Financial Market Trends* 2013, no. 2 (March 20, 2014): 7–14.

<sup>103</sup> Bryan et al., “Harnessing Potential.”

### 3.1. The United Kingdom

#### 3.1.1. Economical Perspective

According to the report<sup>104</sup>, the total transaction amount of Alternative Finance market in the UK in 2015 was around 320 million GBP, which includes 1.09 million investment and 254,721 fundraiser. And business loan of P2P lending has taken 12% portion of SME loans in the UK, which is separately 1% in 2012 and 3% in 2013. As shown in Figure 6 and Figure 7, the portion of business purpose alternative fundraising in the UK has taken 58.72%, which is higher than 16.61% in Europe. Consequently, the development of online business loan in the UK has dramatically 3 times higher than its neighbor countries.

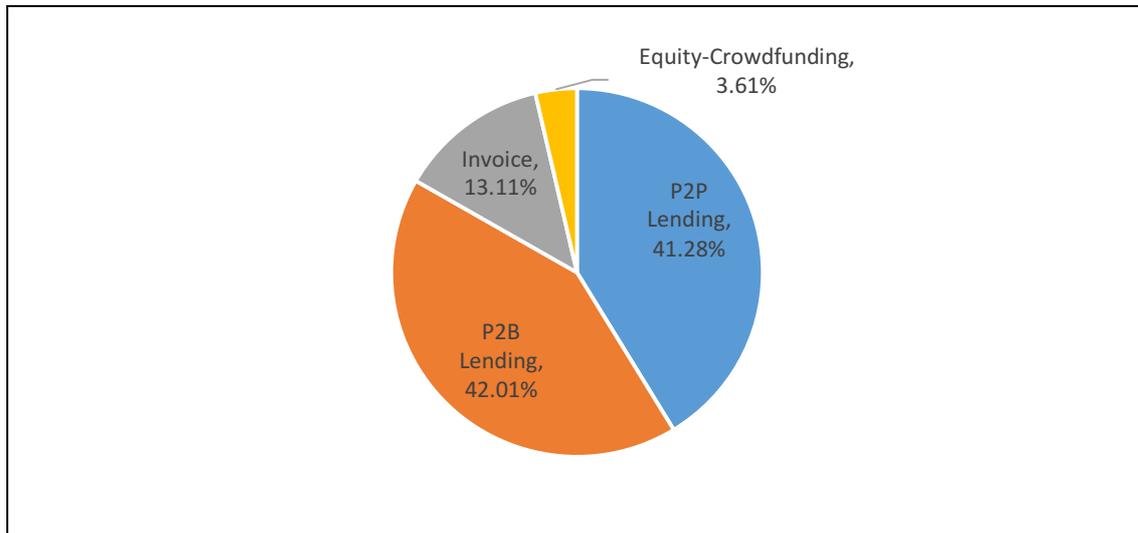


Figure 6: The Portion in the UK

Source: AltFiNews, “AltFi Data Alternative Finance Volume Index - UK,” Market Information, *AltFiNews*, (July 11, 2016). This figure is constructed by author.

<sup>104</sup> Zhang Bryan et al., *Pushing Boundaries: The Third UK Alternative Finance Industry Report*, (Cambridge Centre for Alternative Finance, et al., February 2016).

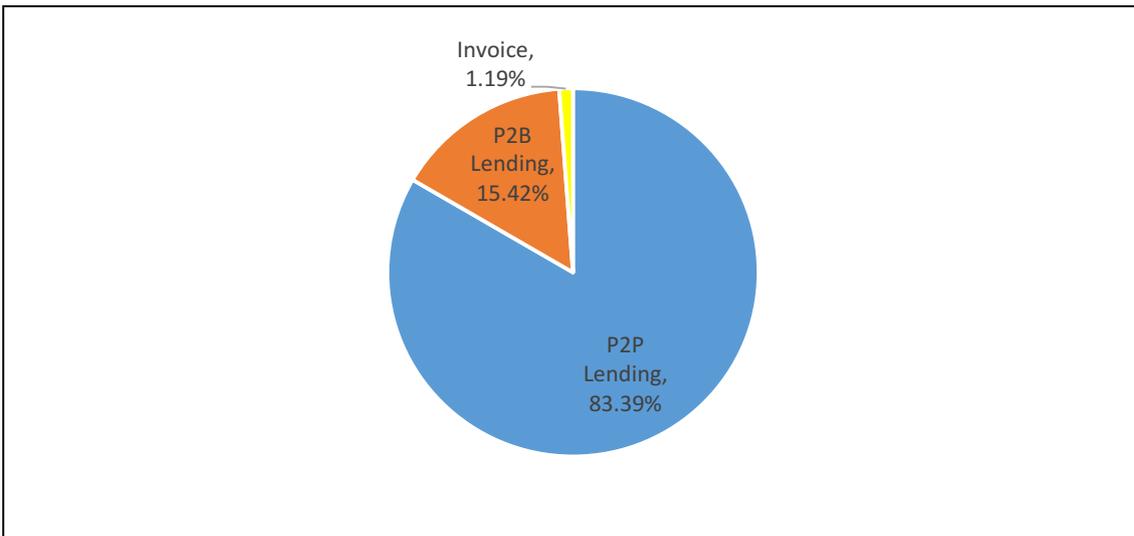


Figure 7: The Portion in Europe

Source: AltFiNews, “AltFi Data Alternative Finance Volume Index - Continental Europe,” Market Information, *AltFiNews*, (July 11, 2016). This figure is constructed by author.

Besides, the rapid development of P2P lending in the UK is also greatly supported by authorities in the UK in two perspectives, which include banks in the UK lend money to SMEs through P2P lending, and P2P lending is under policy of Innovative Finance ISA, which is the coverage of tax exemption. Namely, authorities in the UK provides relevant policies for encouraging investors engaging in investment of P2P lending. From this perspective, it is inevitably that P2P lending in the UK has more experienced in the perspective of market scale and highly support from government.

The following part, this study analyzes 194,728 transaction details, which is largest database among P2P lending industry, provided by Zopa for understanding the function of P2P lending in the UK. There are also many databases of P2P lending disclosed in the UK. Nevertheless, the scale of database is relatively not as large as Zopa. This Dissertation chooses Zopa because it has a long history in P2P lending market and also its comprehensive database for 11 years. Moreover, the

market scale of Zopa, 19.26% of whole P2P lending market, is also key factors that this study picks up as leading models for doing this analyze. The indicators of this analyze includes transaction amount, interest rate, transaction number, and average loan.

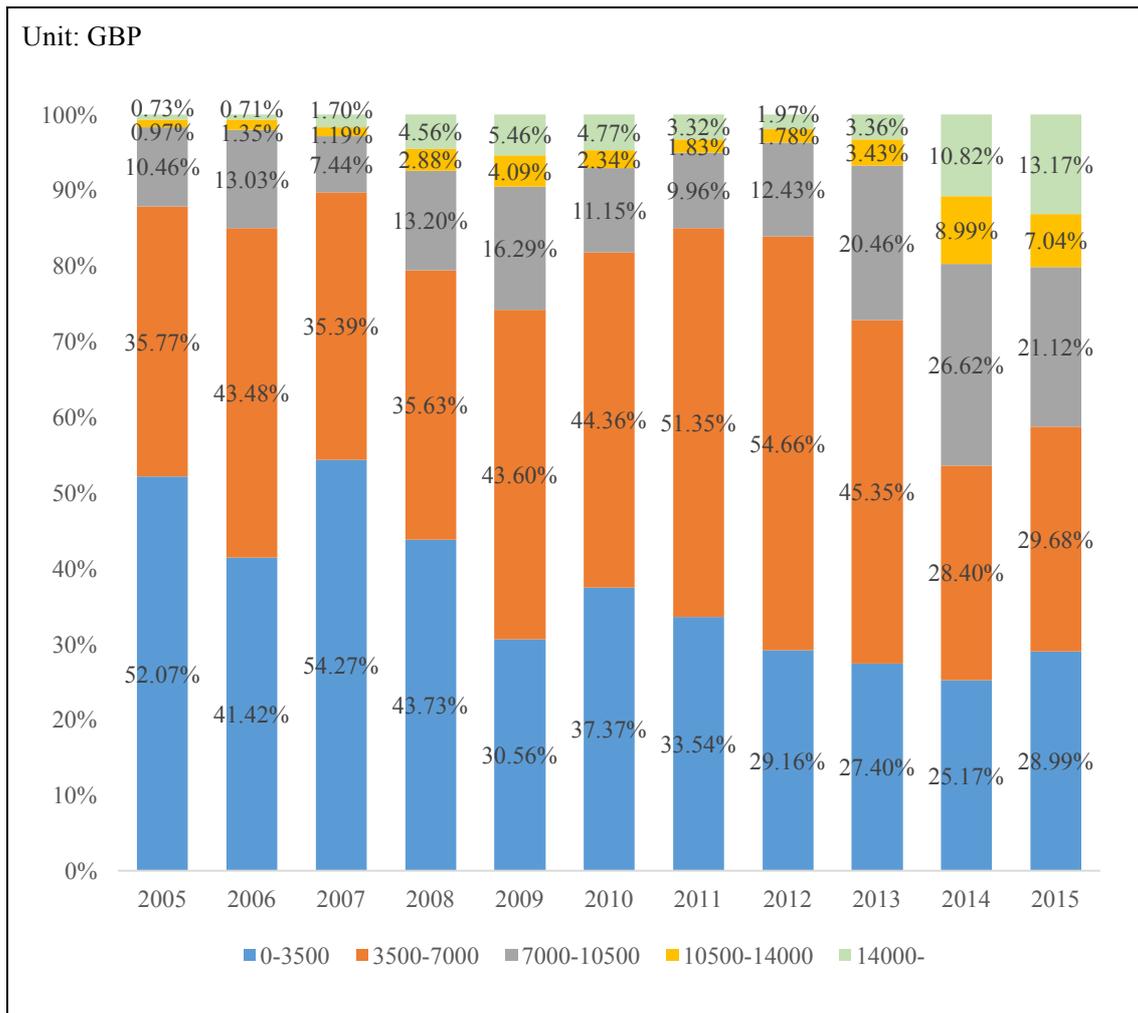


Figure 8: The Portion of Loan Amount in Zopa

Source: Zopa, “Zopa’s Public Loan Book for Peer-to-Peer Lending,” Disclosure Materials of P2P lending platform, *Zopa*, (July 11, 2016). This figure is constructed by author.

As Figure 8 shows above, the amount per loan in Zopa was mostly under 7,000 GBP (around 10,000 USD) from 2005 to 2013. The average portion of loan under 7,000 GBP was taken

approximately 80% during this period. However, Figure 8 also shows that the amount of loan, over 7,000 GBP was increasing dramatically in 2014, 46.43%, which was 27.25% in 2013. Though there was aforementioned transformation, small amount of loan, under 3,500, was taken 25%-30% continuously from 2012. From statistics shown in Figure 8, there are two indicators should be noted, including P2P lending is expanding their market for covering diversified borrowers, and small amount of loan is still one of main core services of P2P lending in the UK.

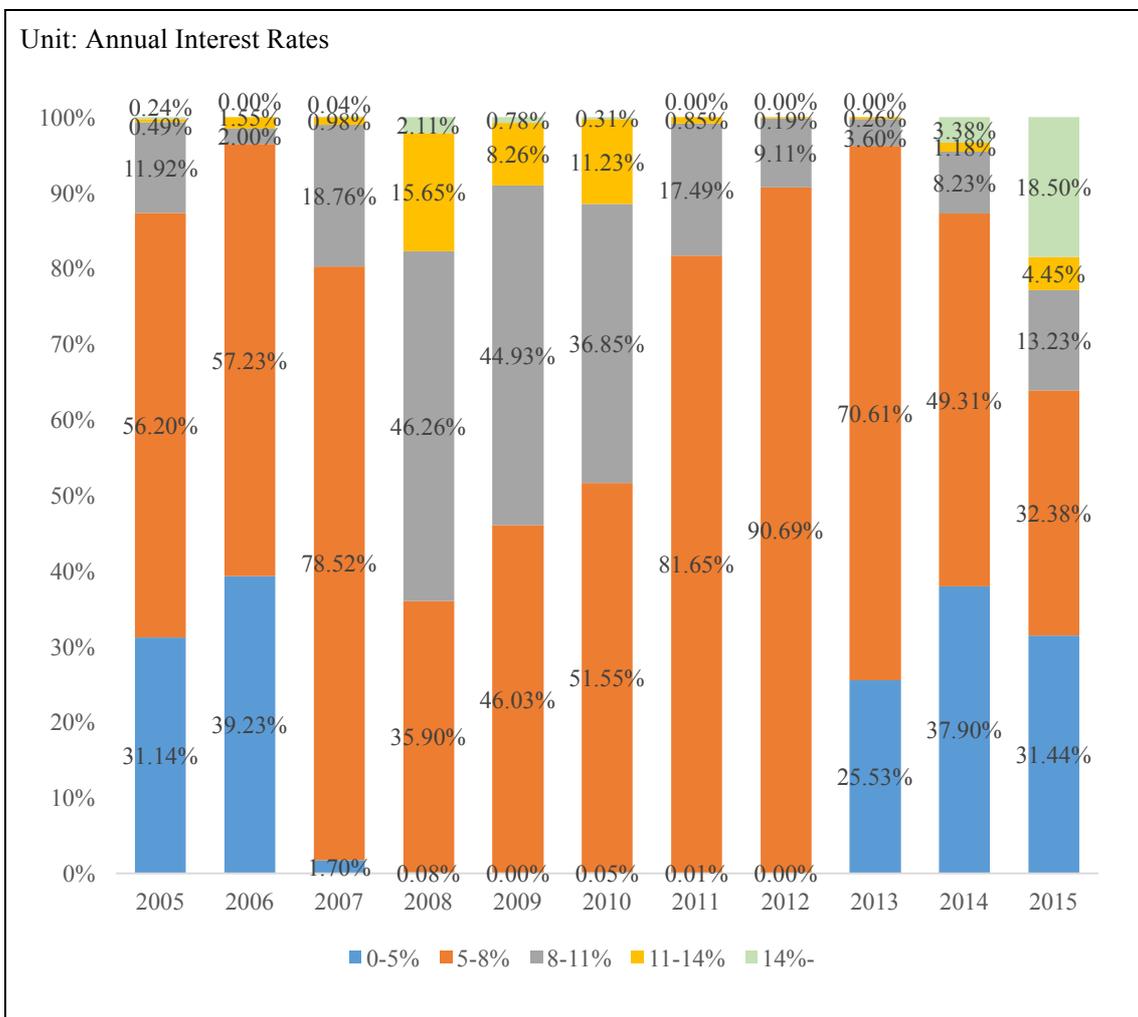


Figure 9: The Portion of Loan Interest in Zopa

Source: Zopa, "Zopa's Public Loan Book for Peer-to-Peer Lending," Disclosure Materials of P2P lending platform, Zopa, (July 11, 2016). This figure is constructed by author.

The portion of loan interest in Zopa is shown in Figure 9. There are three findings should be pointed out from this graph, which includes the portion of interest rates, more than 8%, was increased apparently in 2008; the portion of interest rates, more than 8%, was gradually less from 2008 to 2013; and the portion of interest rates, more than 14%, was dramatically increased, which taken 18.5% portion. Because of financial crisis in 2008, banks raise up their requirement of loan strictly. As a result, there are many borrowers had to find alternative fundraising channel for supplying their demand of loan. From this viewpoint, this research may find that P2P lending works as a supplement role of conventional finance institution in the UK. The same finding could also be found from transformation of decreased portion of loan interest, especially more than 8% from 2008 to 2013. Lastly, the portion of interest higher than 14% was increased in 2015, which may show investors of P2P lending in the UK gradually accept risky loans after several years of development.

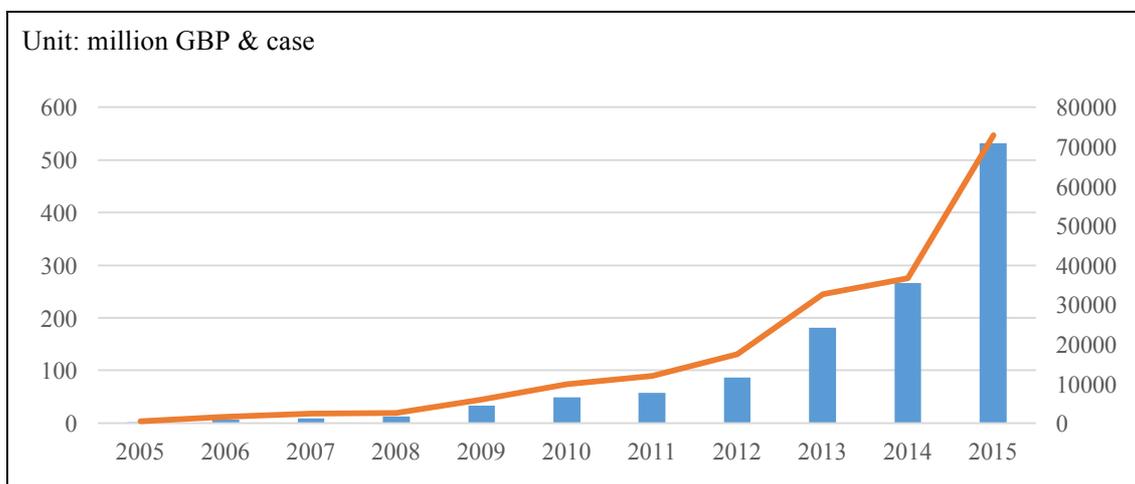


Figure 10: The Annual Total Amount of Cases and Loan in Zopa

Source: Zopa, “Zopa’s Public Loan Book for Peer-to-Peer Lending,” Disclosure Materials of P2P lending platform, *Zopa*, (July 11, 2016). This graph is constructed by the author.

The annual total amount of cases and loan in Zopa is shown in Figure 10, blue blocks and an orange line are separately represented annual total amount of loan and annual total amount of cases in Zopa from 2005 to 2015. In Figure 10, the annual total amount of cases and loan in 2013 and 2015 having dramatically transformation than previous year, which were almost two times. The reasons of aforementioned facts could be caused by P2P lending was gradually be known by borrowers and lenders, and relevant policies and regulation, were already provided by FSA in the UK on April 2014. Some features of P2P lending in the UK is summarized as shown in Table 9. Although there are still many factors may affect the annual total amount of cases and loan, it still showed the relevance between policies and P2P lending industry in the UK.

Table 9: Some Features of P2P Lending in the UK

Feature 1	Half of P2P lending loans are for business purpose in the UK.
Feature 2	Amount and interest rates of P2P loans, the coverage of borrowers and investors were diversified, especially from 2013 or 2014.
Feature 3	The complementary relationship of P2P lending and conventional finance institution in the UK has been shown.

Source: This table is constructed by the author.

Admittedly, the data presented in previous part are inadequate. Although Zopa share the largest market scale among P2P lending platforms of the UK, there still remained 80.74% loans of P2P lending market not covered in discussion of this research. Nonetheless, in terms of operation length of Zopa in the UK, it still shows significant findings of P2P lending market in the UK from 2005 to 2015, for example, half of P2P lending loans are for business purpose in the UK, which is taken 55.12% of whole P2P lending market. In addition, from transformation of amount and interest

rates of P2P loans, the coverage of borrowers and investors are diversified, especially from 2013 or 2014. Moreover, the relevance of P2P lending and conventional finance institution has been shown during financial crisis in 2008, which interest rates of P2P lending increased up and decrease within few years. This Dissertation found that P2P lending shows its influentially supplemental function of conventional finance gradually before 2013 and dramatically enhanced their power until now.

### 3.1.2. Hard-Law Perspective: Openness & Gradualism

#### 3.1.2.1. Stage 1 (2005-2013): Portrait the border of P2P lending

The business of P2P lending in the UK was firstly regulated by Office of Fair Trading (OFT), which was one of relevant authorities of consumer credit business. However, relevant regulation of consumer credit business is not truly applied for P2P lending, a new industry in financial sector. Some of P2P lending platforms had actively consulted with government for pursuing relatively strict requirement for whole industry in 2011<sup>110</sup>. Although one may question that the business operator may tend to have flexible requirement rather than strict regulation, it is still necessary for existed platform excluding new-comer without matured experience, which may dilute reputation of whole industry.

#### 3.1.2.2. Stage 2 (2013-2014): Regulatory Consultation

Financial Conduct Authority has taken over the responsibilities of the consumer credit market from OFT from April 2014, which led P2P lending, a business may involve business of arranging

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<sup>110</sup> James Hurley, "Peer-to-Peer Lenders Join Forces in Regulation Call - Telegraph," Online News, *The Telegraph*, (September 27, 2011).

deals in investments, or the communication of a financial promotion, into regulatory scope of FCA in the UK. In order to provide reasonable regulation toward this new industry, FCA has issued a consultation paper, *The FCA's regulatory approach to crowdfunding and similar activities* on October 2013<sup>111</sup>. After FCA received consultation from general public, FCA has announced a Policy Statement on March 2014, *The FCA's Regulatory Approach to Crowdfunding over the Internet, and the Promotion of Non-Readily Realisable Securities by Other Media Feedback to CP13/13 and Final Rules*, which was implemented on April 2014<sup>112</sup>.

### 3.1.2.3. Stage 3 (2014- ): Relevant Policy Support

In order to encourage potential investors engaging in P2P lending market, The UK Government has taken several measures for supporting this new industry both in direct and indirect way. For instance, the UK Government has directly acted as a borrower for lending money on P2P lending platforms, supporting SMEs raising capital through P2P lending several times<sup>113</sup>. In addition, The UK Government has expanded coverage of existed system of annual ISA investment allowance, including lending funds through P2P lending in the UK from April 2016<sup>114</sup>. ISAs is known as Individual Savings Accounts, including cash ISA, stocks and shares ISA, and innovative finance ISA, which are providing individual investors an annual allowance of tax exemption

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<sup>111</sup> *The FCA's Regulatory Approach to Crowdfunding (and Similar Activities)*, (Financial Conduct Authority, 2013.10).

<sup>112</sup> *The FCA's Regulatory Approach to Crowdfunding over the Internet, and the Promotion of Non-Readily Realisable Securities by Other Media Feedback to CP13/13 and Final Rules*, (Financial Conduct Authority, March 2014).

<sup>113</sup> Innovative Finance ISA, "2017 Guide to The Innovative Finance ISA," Government Policy, *Innovative Finance ISA*, (May 24, 2017). Including Bramley & Gage, a manufacturer of gin and fruit beverages which is based in Bristol; Moo Free Chocolate, a Reading-based company which is widely regarded as a world-leading manufacturer of dairy-free, gluten-free and organic chocolates; Kaizen, a luxury furniture manufacturer.

<sup>114</sup> *Ibid.*

investing in the UK<sup>115</sup>. Based on this policy, investors in the UK have rights to invest P2P lending with receiving tax-free interest and capital gains in certain amount. This is an indirect policy for supporting P2P lending industry.

### 3.1.3. Soft-Law Perspective: Independence, Neutrality & Transparency

#### 3.1.3.1. History Development in the UK

“Britain appears to be something of a haven for self-regulation<sup>116</sup>”, which shows that there are some unique characteristics of self-regulation in the UK, which may be regarded as relatively successful compared with development of other countries. In this part, this study tries to cover some issues of history, industry practice, and market structure relating to development of self-regulation in the UK, which includes the convention of gentle agreement, practice of industry self-regulation, and self-regulation in finance sectors. This analysis is a critical part for this Dissertation because a successful legal mechanism may already have developed for a couple decades or centuries in transplanted countries. In order to provide a relatively successful or applicable legal transplantation, this study tries to address the issue of self-regulation before going to details of self-regulation and government regulation of P2P lending in the UK.

In history, British Elite has taken important political and non-political positions in terms of distribution of power<sup>117</sup>. A group of British Elite is regarded as working closely and exclude outsiders<sup>118</sup>. As a result, the reputation should be maintained for their long term relationship among a

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<sup>115</sup> GOV.UK, “Individual Savings Accounts (ISAs): How ISAs Work,” Official U.K. government website, *GOV.UK*, (May 24, 2017).

<sup>116</sup> Rob Baggott, “Regulatory Reform in Britain: The Changing Face of Self-Regulation,” *Public Administration* 67, no. 4 (1989): 438.

<sup>117</sup> Philip Stanworth and Anthony Giddens, *Elites and Power in British Society* (CUP Archive, 1974).

<sup>118</sup> Baggott, “Regulatory Reform in Britain,” 443.

group. In this viewpoint, members of an elite group are highly relying on self-discipline and gentlemen's agreement. Based on this historical factor, a mechanism of self-regulation that has been practiced for a long time, which may be a foundation of their modern self-regulation system.

The industry self-regulation of advertising, chemicals, professions, the Press, and financial services in the UK has been notably discussed by academia<sup>119</sup>, which shows its prosperity and wide coverage of self-regulation practice in British society. For instance, advertising activities in the UK was highly restricted by statutory regulation provided by self-regulation entities<sup>120</sup>, which includes broadcast media, non-broadcast media, and professions rather than government regulation in whole.

The regulatory framework of securities in the UK is regarded as a mixture of both statutory and self-regulatory provisions<sup>121</sup>. The Companies Acts and The Prevention of Fraud (Investments) Act are some examples of statutory provisions. The Stock Exchange and The Panel and the Council for Securities Industry are self-regulation entities, which provide rules of the City, securities industry in the UK. The power of self-regulation entities is influential, for example, conducts of the market, market dealers, and disclosure duty of listing companies are regulated by self-regulation rules. Although there are some government regulations provided toward securities industry, such as Financial Services Act, it is sometimes the measures for keeping their regulation ranks and following international standard<sup>122</sup>.

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<sup>119</sup> Ibid. at 438.

<sup>120</sup> Rob Baggott and Larry Harrison, "The Politics of Self-Regulation: The Case of Advertising Control," *Policy & Politics* 14, no. 2 (1986): 144.

<sup>121</sup> Graham F. Pimlott, "Reform of Investor Protection in the UK—An Examination of the Proposals of the Gower Report and the UK Government's White Paper of January, 1985," *J. Comp. Bus. & Cap. Market L.* 7 (1985): 142.

<sup>122</sup> Baggott, "Regulatory Reform in Britain," 448.

In this part, it is admittedly that there still remain numbers of practices of self-regulation in the UK not be discussed in details. However, based on the above discussion, it has shown that self-regulation is a unique characteristic in terms of regulatory framework in the UK, which has its own history, developed from gentlemen’s agreement among elite class in tradition, as shown in Table 10. There are also many examples of industry self-regulation, which shows its influential power on industry rules. However, the influence of self-regulation is still larger than government in some industries. Lastly, financial regulation of securities industry is mixture of government regulation and self-regulation and entities of self-regulation also show its influential power on regulation of conducts of the market, market dealers, and disclosure duty.

Table 10: History Perspective and its Effect on Self-Regulation in the UK

Item	Content
The Convention of Gentle Agreement	Members of an elite group are highly relying on self-discipline and gentlemen’s agreement in British tradition, which may be a foundation of their modern self-regulation system.
Practice of Industry Self-Regulation	Industry self-regulation has wide coverage and substantial power in terms of self-regulation rules in British society.
Self-Regulation in Finance Sectors	The regulatory framework of securities is regarded as a mixture of both statutory and self-regulatory provisions, which entities of self-regulation have substantial power on regulation of conducts of the market, market dealers, and disclosure duty.

Source: This table is constructed by the author.

Based on above characteristics of industry self-regulation in the UK, this research picks up P2P lending industry as examples for doing analysis of self-regulation and its effectiveness on British P2P lending industry. In order to understand the industry self-regulation of P2PFA, this Dissertation firstly analyzes market factors of P2P lending industry. After understanding market factors, this study further includes relevant regulation and policy in the UK for clarifying the intervention of P2P lending industry from rules made by government sectors.

### 3.1.3.2. Independence: Bottom-Up Structure

Peer-to-Peer Finance Association (P2PFA) was established by RateSetter, Zopa and Funding Circle in 2011<sup>123</sup>. According to statistics<sup>124</sup>, Zopa, RateSetter, and Funding Circle are top three cumulative total transaction amount among P2P lending industry in the UK, separately in 19.26%, 18.33%, and 17.62%, which are more than half (55.21%) of whole P2P lending market scale. In this viewpoint, there are two characteristics of P2PFA, which includes P2PFA covered main stakeholders of market in the beginning stage of this association, and founders of P2PFA have influential power and overwhelm scale of P2P lending market in the UK.

The missions of P2PFA are threefold<sup>125</sup> as shown in Table 11, which includes maintain and promote high standards of business conduct in the market, try and educate people and raise awareness, and lobby for an effective regulatory regime. Moreover, members of the P2PFA are

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<sup>123</sup> Peter Renton, *Podcast 48: Christine Farnish of the P2PFA*, Transcript, podcast, Lend Academy, (n.d.).

<sup>124</sup> AltFiNews, "AltFi Data Alternative Finance Volume Index - UK," Market Information, *AltFiNews*, (July 11, 2016).

<sup>125</sup> Renton, *Podcast 48: Christine Farnish of the P2PFA*.

required to meet self-regulation rules<sup>126</sup> and operating principles<sup>127</sup> for the transparent, fair and orderly operation of P2P finance. From above three missions of P2PFA, its market-driven characteristics have been shown.

P2P lending industry, as an innovative finance system, is relatively not as matured as conventional financial institutions. Moreover, in the beginning development stage of the UK market, there is no specified regulation toward this industry until 2014. As mission one indicated, members of P2PFA try to promote high standard of their business conduct. In this viewpoint, members of P2PFA want to maintain a good reputation for further development of market and government regulation, as a key motivation.

Another example of market-driven characteristics of P2PFA is shown by mission three. As mission three indicated, they were dedicated to lobby an effective regulatory regime. In order to achieve goal of mission three, P2PFA indeed had discussions with Treasury in the UK many times. Finally, P2P lending was recognized as an industry by government<sup>128</sup>. P2PFA also works closely with the FCA, financial authorities in the UK, ensuring the regime proposed by governments were applied to them<sup>129</sup>. From this perspective, members of P2PFA pursued their maximized benefits of relevant regulation of P2P lending industry.

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<sup>126</sup> *Rules of The Peer-to-Peer Finance Association 2015.*

<sup>127</sup> Peer-to-Peer Finance Association Operating Principles.

<sup>128</sup> Renton, *Podcast 48: Christine Farnish of the P2PFA*. "...So we went to talk to government first because they're the ones that control what does and doesn't get regulated. We had a lot of conversations with the Treasury in the UK and the Treasury eventually agreed to define peer to peer lending and add us on to the statutes that has to be agreed by Parliament that defines the scope of what the financial services regulator does. So that was a big win..."

<sup>129</sup> *Ibid.* "...So our next job was really lobbying and working closely with the FCA to try and ensure that the regime we ended up with was fit for purpose, properly risked based and proportionate because obviously, we're small businesses and we are trying to break into very tough or established markets so it's no good lumbering off with a whole load of very, very costly and burdensome things that we have to do because it would just kill the business altogether..."

Table 11: Brief Overview of P2PFA<sup>130</sup>

Item	Content	Note
Established Date	2011	Before relevant regulation are implemented in 2014
Founded Member	Zopa, RateSetter, and Funding Circle	Top 3 platforms of P2P lending in the UK
Mission 1	Maintain and promote high standards of business conduct in the market	Disclosure duties are required
Mission 2	Try and educate people and raise awareness	Promote P2P lending
Mission 3	Lobby for an effective regulatory regime	Ensure relevant policies will be applied for P2P lending in practice

Source: This table is constructed by the author.

There are two main features of P2PFA. First, charter members of P2PFA had influential power of P2P lending market as their transaction scale were the top three in the UK. Additionally, P2PFA is mainly established by industry without any indication of intervention from governments. Second, missions of P2PFA were trying to establish a standard for their members before relevant regulation issued by financial authorities as there was demand for ensuring stability of this new industry. In addition, they were also dedicated to educate investors for understanding this market. Based on the brief introduction of P2PFA, this research found that P2PFA is motivated by stakeholders of P2P lending industry in the UK, especially P2P lending platforms, which may be regarded as a highly market-driven association.

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<sup>130</sup> The table is originally created by author.

### 3.1.3.3. Structure Neutrality: Composition of Members in P2PFA

It is estimated that there are approximately 27 platforms of P2P lending in the UK. Currently, as shown in Table 12, there are eight platforms as members of P2PFA until 2016, including three charter members, Zopa, RateSetter, and Funding Circle. In 2013, ThinCats joined in August<sup>131</sup> and LendInvest in September<sup>132</sup>. In 2014, MarketInvoice has joined in March<sup>133</sup>, Lending Works in October<sup>134</sup>, and Landbay in November<sup>135</sup>. Though market shares of 5 of all 8 members are more than 10%, there are still 3 members, which may not be as influential in P2P lending market as previous 5 members due to their relatively low market scale. The largest one is Zopa, which has long history in the UK. The smallest one is Landbay, which is only taken 0.23% of P2P lending market. Compared with Landbay, Lending Works, and ThinCats as shown in Table 13, there are still some non-P2PFA members having larger market scale. From above fact, this Dissertation found that the market shares of P2P lending platforms may not be key factors of being a member of P2PFA.

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<sup>131</sup> AltFiNews, "ThinCats to Join Peer-to-Peer Finance Association," Industry News, *AltFiNews*, (August 18, 2013).

<sup>132</sup> Lendinvest, "LendInvest Joins £600m Revolution," P2P lending platform, *Lendinvest*, (July 11, 2016).

<sup>133</sup> AltFiNews, "Leading Invoice Trader Joins P2PFA," Industry News, *AltFiNews*, (March 4, 2014).

<sup>134</sup> AltFiNews, "P2PFA Opens Gates to New Platform," Industry News, *AltFiNews*, (October 2, 2014).

<sup>135</sup> AltFiNews, "All Systems Go at the P2PFA," Industry News, *AltFiNews*, (November 26, 2014).

Table 12: The Basic Information of P2PFA Members

Unit: GBP

No.	Company Name	Established Year	Market Shares	Amount	Founder
1	Funding Circle	2010	17.62%	£1,436,344,960	V
2	Landbay	-	0.23%	£42,780,019	-
3	Lending Works	2012	0.57%	£32,765,866	-
4	LendInvest	2013	10.21%	£723,989,618	-
5	MarketInvoice	2010	13.49%	£868,538,764	-
6	RateSetter	2009	18.33%	£1,371,597,524	V
7	ThinCats	2011	1.85%	£188,502,000	-
8	Zopa	2004	19.26%	£1,648,196,244	V

Source: AltFiNews, “AltFi Data Alternative Finance Volume Index - Continental Europe,” Market Information, *AltFiNews*, (July 11, 2016). This table is constructed by the author.

Basic information of non-P2PFA members is shown in Table 13. There are around 19 platforms not covered as members of P2PFA currently. However, the total market scale of these P2P lending platforms is only around 18.46%. Specifically, from the perspective of amount of members in P2PFA, this association is covering less than one third of the whole industry. Nevertheless, from the perspective of market scale, the coverage is more than 80% of whole P2P lending industry. The average market scale of non-P2PFA platforms is around 0.97% though there is still remained huge gap. Specifically, the highest is 4.86% and the lowest is less than 0.1%. As previously discussed, members of P2PFA, such as ThinCats, market scale is only around 2%. However, non-P2PFA platforms, such as Saving Stream is around 4.86%, which is two times higher than ThinCats.

Table 13: The Basic Information of non-P2PFA Members

Unit: GBP

No.	Company Name	Market Shares	Amount
1	Funding Secure	1.97%	£53,186,818
2	Lendable	0.86%	£26,957,595
3	Assetz Capital	2.69%	£141,519,575
4	Rebuildingsociety	0.06%	£10,100,000
5	FundingKnight	0.05%	£31,105,000
6	Abundance Generation	0.34%	£20,877,829
7	Saving Stream	4.86%	£177,359,694
8	Folk 2 Folk	1.43%	£111,770,801
9	Wellesley & Co.	2.94%	£345,042,066
10	Money & Co.	0.07%	£7,689,210
11	ArchOver	0.42%	£21,427,000
12	Us Bond Network	0.00%*	£7,981,000
13	Crowdcube Minibonds	0.00%*	£16,670,950
14	Relendex	0.09%	£5,651,000
15	Crowdbnk Minibonds	0.00%*	£6,570,804
16	Proplend	0.16%	£8,935,500
17	MoneyThing	1.08%	£24,741,404
18	LendingCrowd	0.09%	£0
19	Platform Black	1.35%	£141,322,892

Source: AltFiNews, “AltFi Data Alternative Finance Volume Index - Continental Europe,” Market Information, *AltFiNews*, (July 11, 2016). This table is constructed by the author.

From the perspective of structure neutrality, this study found that P2PFA has three characteristics, which includes high coverage rates: the market share of their members are adequate, which is 81.56%; credibility: major market players are included; and fairness: platforms with tiny

transaction amount are included as well. With high coverage rate, credibility, and fairness, the impact of self-regulation rules could be influential.

#### 3.1.3.4. Self-Regulation Example: Self-Regulation Rules of P2PFA

In order to enhance transparency and customer protection of P2P lending in the UK, P2PFA has provided relevant self-regulation rules as obligations of their P2P lending platform members from the beginning stage of association establishment<sup>137</sup>, including Rules of The Peer-to-Peer Finance Association<sup>138</sup> and Peer-to-Peer Finance Association Operating Principles<sup>139</sup>. Generally, Rules of The Peer-to-Peer Finance Association are articles of association of P2PFA. A member of P2PFA should follow rules of Peer-to-Peer Finance Association Operating Principles. With the development of P2P lending industry in the UK, relevant standards of Peer-to-Peer Finance Association Operating Principles has been amended. In following part, this Dissertation analyzed aforementioned two rules of P2PFA and its amendments for understanding their main characteristics and successful factors in terms of self-regulation.

Rules of The Peer-to-Peer Finance Association (hereafter Rules) have firstly been provided in 2011 and amended on May 2015. There are 14 articles of Rules. Basically, Rules contains two major parts, which include structure of P2PFA and substantial provisions. In following part, this research will not go into details of structure of P2PFA but picks up substantial provisions, such as objectives

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<sup>137</sup> Peer-to-Peer Finance Association, "Launch of Peer-to-Peer Finance Association," Industry Association, *Peer-to-Peer Finance Association*, (August 15, 2011).

<sup>138</sup> Rules of The Peer-to-Peer Finance Association 2015.

<sup>139</sup> Peer-to-Peer Finance Association Operating Principles.

and membership of P2PFA for understanding why P2PFA was established and entry requirement of membership.

In Article 3 of Rules, there are four major objectives of P2PFA, which includes to seek, to secure public policy, regulatory and fiscal conditions that enable the UK-based Peer-to-Peer Finance sector to compete fairly and grow responsibly; to ensure that Members demonstrate high standards of business conduct, to demonstrate leadership and to promote confidence in the sector; to raise awareness and understanding of the benefits and risks of Peer-to-Peer Finance; and such other objectives as the Board thinks fit.

Based on the overview, there are some key characteristics, which includes the objectives of P2PFA are quite clearly indicating that the connection between high standard conduct and enhancing their business in the market; P2PFA is set up for actively achieving an applicable regulation for whole market rather than protect their own benefits passively; and P2PFA is not only promote P2P lending business but also try to disclosure risks of this industry.

According to Rules of P2PFA, prospective new members must have been transacting business in the market for at least six months. Furthermore, there are also four points being as members of P2PFA shown in Table 14, which could be refined as means, core of business, operation, and disclosure. Basically, the prospective members should do their business through electronic platform, which exclude conventional business. In addition, there is also limitation of core business. The disclosure duty is also criteria of membership. In other words, prospective members should show their compliance with disclosure duty provided by P2PFA.

Table 14: P2PFA Membership Criteria

No.	Category	Content
1	Means	Undertake debt based retail financial services business in the UK by means of an electronic platform
2	Core of Business	Use lender funds to provide loan funding of any type to consumer or business customers
3		Secure some lender funds from retail consumers where possible
4		Operate to a significant extent by means of direct loan contracts between borrowers and lenders
5	Operation	Demonstrate high standards of credit risk and operational risk management
6	Disclosure	Demonstrate high standards of transparency and provide clear, balanced and fair information to all customers
7		Comply fully with the P2PFA's Operating Principles

Source: Peer-to-Peer Finance Association, "Rules of P2PFA," Industry Association, *Peer-to-Peer Finance Association*, (July 11, 2016). This table is constructed by the author.

As members of P2PFA, they will be listed on the website of P2PFA and will be permitted to use the Association's logo. Namely, membership of P2PFA is also like a certificate for guarantee. Specifically, based on membership criteria, P2PFA is working as a gatekeeper role for selecting qualified P2P lending platforms, which investors could easily access the list of their members on website. A member of P2P lending platform could also put logo of P2PFA on its website for showing its high standard compliance of disclosure duty. From this viewpoint, P2PFA is also working as an agency for reducing information cost between P2P lending platforms and potentials users of P2P lending.

Specifically, P2PFA set up a membership requirement with disclosure duty, which may benefit among P2PFA, P2P lending platforms, and users of P2P lending. From the perspective of P2PFA, their membership will be regarded as reliable certificate if their members have good reputation.

Moreover, P2PFA will attract more P2P lending platforms applying as a member for enhancing public trust; From the viewpoint of P2P lending platforms, they can benefit from well-reputation of their industry and high standard disclosure. At first glance, P2P lending platforms may not be willing to participate as a member because there are not so many competitors disclosing their transaction data. In other words, they will gain their cost of comply with disclosure duty. However, if there are already certain amounts of their competitors following P2PFA disclosure duty, they may lose their trust due to relatively not transparent; users of P2P lending benefits from low information cost contributed by P2PFA and their members for making decision with sufficient materials.

According to Article 6 of Rules, members of P2PFA are required to comply with the Operating Principles determined by a two-thirds majority of the Board. Besides, Article 1 of Peer-to-Peer Finance Association Operating Principles (hereafter Operating Principles) also indicates that the standards of business conduct applying to all members of the P2PFA. As a result, it is a mandatory requirement for P2PFA members to follow Operating Principles.

Though there are 29 articles of *Peer-to-Peer Finance Association Operating Principles*, this study has refined as main parts as shown in Table 15, including (1) prohibition of misleading advertisement: platforms must not claim that investors' returns are guaranteed<sup>141</sup>; (2) mandatory disclosure duties: bad debt rates, returns performance, and full loan book availability<sup>142</sup>; (3) obligation of explanation to clients: details of any fees and charges, how money is treated after a lender transfers it to the platform, any conflict of interest in any of the loans and how conflicts of interest are managed, and so on; (4) client money management: members shall segregate their

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<sup>141</sup> Article 4, Peer-to-Peer Finance Association Operating Principles

<sup>142</sup> Article 6, Peer-to-Peer Finance Association Operating Principles

customers' funds from member's own funds and company assets, in a segregated bank account<sup>143</sup>;

(5) prohibition of interest conflict: members should not borrow or raise funds through their p2p lending websites or platforms<sup>144</sup>.

Table 15: Five Main Categories of P2PFA Operating Principles

Prohibition of misleading advertisement	platforms must not claim that investors' returns are guaranteed
Mandatory disclosure duties	<ol style="list-style-type: none"> <li>1. bad debt rates</li> <li>2. returns performance</li> <li>3. full loan book availability</li> </ol>
Obligation of explanation to clients	<ol style="list-style-type: none"> <li>1. details of any fees and charges</li> <li>2. how money is treated after transfers to the platform</li> <li>3. any conflict of interest in any of the loans and how conflicts of interest are managed</li> </ol>
Client money management	<ol style="list-style-type: none"> <li>1. segregate their customers' funds from member's own funds</li> <li>2. segregate their customers' funds from company assets</li> </ol>
Prohibition of interest conflict	Members should not borrow or raise funds through their P2P lending websites or platforms

Source: *The FCA's Regulatory Approach to Crowdfunding over the Internet, and the Promotion of Non-Readily Realisable Securities by Other Media Feedback to CP13/13 and Final Rules*, (Financial Conduct Authority, March 2014), 13. This table is constructed by the author.

### 3.1.4. Co-Regulation Perspective: Complementation between Hard-Law and Soft-Law

Based on brief overview as introduced previously, this research will compare P2PFA

Operating Principles (soft-law) and regulation<sup>146</sup> provided by FCA (hard-law) for understanding the

<sup>143</sup> Article 13, Peer-to-Peer Finance Association Operating Principles

<sup>144</sup> Article 23, Peer-to-Peer Finance Association Operating Principles

<sup>146</sup> "The FCA's Regulatory Approach to Crowdfunding over the Internet, and the Promotion of Non-Readily Realisable Securities by Other Media Feedback to CP13/13 and Final Rules," 13.

role of P2PFA Operating Principles. This Dissertation selects 12 items of regulation point of P2PFA Operating Principles for this comparative analysis. There are six overlapped fields that both self-regulation and FCA regulation have covered, as shown in Table 16, which means that there are another 6 items mainly regulated by self-regulation in P2P lending industry, which includes (1) prohibition of misleading advertisement, (2) disclosure of bad debt rates, (3) full loan book availability, (4) main duty of explanation to clients, (5) bad debt recovery, and (6) prohibition of interest conflict. It is admittedly that this comparative analysis could not cover both whole regulation P2PFA and FCA. However, based on examination of 12 items, this study found that self-regulation of P2PFA widely cover above fields in detail, especially in categories of misleading advertisement, and mandatory disclosure duties, which are more technical regulation, relying on profession of industry.

In this regard, the industry of P2P lending in the UK may be regarded as co-regulated by P2PFA from soft-law perspective and FCA from hard-law perspective. The regulation provided by FCA confirms that the industry should be regulated and how to regulate from broad overview. The rules provided by P2PFA work as an auxiliary measure to self-regulate this industry promptly and dynamically. Given that the industry of P2P lending changes rapidly, it is necessary to consider how to regulate this innovative industry from both static and dynamic way. Specifically, the regulation provided by FCA is enforceable but normally take some time for policy making procedure, which is static. In contrast, the self-regulation rules provided by the industry association, such as P2PFA, has more flexibility in terms of meeting demand from market immediately, which is dynamic.

Table 16: The Complementation of Regulation by P2PFA and FCA

	Categories	Items	P2PFA	FCA Regulation
1	Prohibition of misleading advertisement		V (Article 4)	X
2	Mandatory disclosure duties	Bad debt rates	V (Article 6.a)	X
		Returns performance	V (Article 6.b)	V (FCA Financial Promotions COBS 4.6.2.)
		Full loan book availability	V (Article 6.c)	X
3	Obligation of explanation to clients	Main duty of explanation	V (Article 7)	X
		Information for borrowers	V (Article 8)	V
4	Client money management	Credit risk management	V (Article 11)	V (SYSC <sup>149</sup> 7.1)
		Bad debt recovery	V (Article 16)	X
5	Prohibition of interest conflict		V (Article 23)	X
6	Other	Anti-money laundering and fraud prevention	V (Article 12)	V (SYSC 3.2.6)
		IT systems and controls	V (Article 14)	V (SYSC 3.1.1)
		Records and documents management	V (Article 15)	V (SYSC 9.1)

Source: *Senior Management Arrangements, Systems and Controls*, (Financial Conduct Authority, May 2017). This table is constructed by the author.

<sup>149</sup> *Senior Management Arrangements, Systems and Controls*, (Financial Conduct Authority, May 2017).

### 3.1.5.Characteristics of Regulatory Framework in British P2P Lending

In this Chapter, this research firstly introduces theories of industry self-regulation for understanding what is industry self-regulation. Through literature reviews, there are advantages and criticism of industry self-regulation, which are caused by diversified background of social and economic context, the effectiveness and accountability. Based on this viewpoint, this study has divided analysis of P2P lending industry self-regulation in the UK into two major parts, which includes (1) external factors, and (2) internal factors.

#### 3.1.5.1. External factors

There are several issues addressed in this Chapter, which includes (1) historical perspective in the UK, (2) market factors of P2P lending, and (3) regulation and policy of P2P lending. It is evitable that the history gentlemen's agreement practice in the UK has provided a well foundation for modern industry self-regulation. In addition, industry self-regulation has also worked well in many aspects in the UK for couple of decades, such as the Press and finance industry. The recent rapid development of P2P lending market also accelerates the demand of regulation from market for disputed resolution. Moreover, regulation and policy also have relevance with industry self-regulation of P2P lending, which includes lack of regulation, and lobby by P2PFA. In order to clarify influential factors and common factors, this Dissertation categorized them in Table 17. The symbol “V” and “△” have separately represent the meaning of “direct” and “indirect” factors.

### 3.1.5.2. Internal Factors

There are several issues addressed, which includes (1) the history of P2PFA, (2) members of P2PFA, and (3) rules of self-regulation. P2PFA has been established by three main players of P2P lending industry, which has significant effect on its development. In other words, the concern addressed in theory is that the coverage of a self-regulation entity may not be comprehensive. With more than half market scale of P2P lending industry, the foundation of this association is solid. Additionally, P2PFA was established before government regulation, which is an important factor that self-regulation of P2P lending industry has more flexibility for designing their rules. From structures of P2PFA, it also shows the diversity of its membership, which includes platform with tiny transaction amount. And high standard disclosure duty of P2PFA and its effectiveness of implementation are also crucial factors of self-regulation.

From the analysis of this chapter, P2PFA and its effectiveness of self-regulation rules are caused by both external factors and internal factors as shown in Table 17. Specifically, P2PFA is not the only case of industry self-regulation in the UK. The mechanism of industry self-regulation has been practiced in several aspects for decades or centuries. Without this foundation of relevant characteristics, such as history, industry practice, and market structure, it is hard to copy the model of P2PFA and its rules for implementation, especially “pure” self-regulation as P2PFA without government intervention. Specifically, the independence of the industry association in the UK is practiced for several decades and gradually developed. With independence, the industry association could provide their industry opinions and contribute into regulatory framework as what P2PFA does. There are still many factors not taken into discussion in his research, such as how is the decision making process of P2PFA, why there are still some P2P lending platforms with competitive market

scale not joining P2PFA, and what are attitudes of member and non-member of P2PFA toward current self-regulation rules. In following section, this study will be based on above factors for examine whether it is possible for borrowing experiences of P2PFA and transplanting them into China.

Table 17: Factors of Industry Self-Regulation of P2P lending in the UK

Theories of Industry Self-Regulation		
Introduction	Because of diversified background of social and economic context, the effectiveness and accountability will be also influenced variably as well	
Advantages & Challenges	<ol style="list-style-type: none"> <li>1. Self-regulation may work as supplemental role of government</li> <li>2. Coverage of an entity of industry self-regulation may be low; lack of effective enforcement power</li> </ol>	
External Factors		
Historical Perspective in the UK	1. The convention of gentle agreement	△
	2. Long practice of industry self-regulation	△
	3. Self-regulation in finance sectors	√
Market Factors	1. The users of P2P lending grows up rapidly	√
	2. The amount of loan in per capital grows	√
	3. The mechanism becomes matured	△
Regulation and Policy	1. Lack of Regulation before 2014	√
	2. Lobby by P2PFA	√
	3. Supporting policy from 2014	△
Internal Factors		
The History of P2PFA	1. Founders of P2PFA are 3 major players	√
	2. Established before government regulation	√
Members of P2PFA	1. The members are diversified in terms of transaction amount	√
	2. The coverage of market scale by P2PFA members are more than 80%	√
Rules of Self-Regulation	1. Membership of P2PFA is like a certificate for guarantee	√
	2. High standard disclosure duty	√
	3. Complementation with FCA regulation	△

Source: This table is constructed by the author.

## 3.2. China

### 3.2.1. Economical Perspective

According to recent statistics<sup>151</sup>, the cumulative amount of peer-to-peer lending platforms established in China is already approximately 4,127 in July 2016. The total transaction amount of Chinese P2P lending industry in 2015 is 92.07 billion USD<sup>152</sup>. Compared with the annual transaction amount in 2013, 5.29 billion USD<sup>153</sup>, it increased more than 1740% within two years. Furthermore, the business scale of P2P lending in China is 135 times larger than other Asia-Pacific countries, which is 681.73 million USD<sup>154</sup>. Based on aforementioned facts of P2P lending industry in China, this market is rapidly developing and relatively prosperous than other countries.

However, it cannot be ignored that there are also 1,778 platforms going bankruptcy or terminating their business in the past few years<sup>155</sup>. The reasons of bankruptcy including fraud crime<sup>156</sup>, and immature operation<sup>157</sup>. In other words, the P2P lending industry in China is still at a trial period. The quality among these platforms are quite different. Only 38 judicial cases are decided and found on electronic databases in China<sup>158</sup>. The percentage of problematic platform cases going to court is only around 2%, which may imply many P2P lending investors in China suffered from

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<sup>151</sup> Wangdaizhijia [网贷之家], “The Statistics of P2P Lending” [网贷之家数据], Credit Rating Report, 网贷之家, (July 11, 2016).

<sup>152</sup> Bryan et al., “Harnessing Potential.”

<sup>153</sup> Ibid.

<sup>154</sup> Ibid.

<sup>155</sup> Wangdaizhijia, “Updated List of Problematic P2P Lending Platforms.”

<sup>156</sup> Peng, “P2P Lending and Illegal Fundraising,” 20–22.

<sup>157</sup> Ouyang Rihui (欧阳日辉), *Regulation of Internet Finance: Self-Discipline, Inclusiveness and Innovation* [互联网金融监管：自律、包容与创新] (Beijing: Economic Science Press, 2016), 181–83.

<sup>158</sup> China Judgements Online, “China Judgements Online.” Use “P2P Lending(网贷)” as the searching term and choose category “Criminal case(刑事案由).” The total number of searching results is 48. However, some of cases are duplicated. For example, the same case in district court and high court. Accordingly, the exact number of cases is 38. See Appendix 1.

losing their investment and having limited opportunities to access judicial resources. Though some cases investigated by polices and go to court, it still takes on the average 14 months for judicial procedures<sup>159</sup>.

The difficulties for small and middle enterprises(SMEs) to raise funds from capital market are universal problems in the world. The financing channels of enterprises could be divided into direct and indirect financing ways<sup>160</sup>. In China, according to a survey, only 15.6% of enterprises choose direct financing channels, for example, IPO or issue bond. For SMEs, they do not have enough abilities to afford the cost and credit of direct financing channels. They would like to choose indirect way, such as borrowing money from the bank. However, the successful raising of funds may be based on enough credit and collateral.

Without the certain scale of business as credit and enough real-estate as collateral, it is hard for SMEs to break the vicious circle and get the funding from the bank to enhance their cash flow. Since the financial crisis in 2008, as SMEs, the situation of raising funds become worse than ever before. Under the tough situation, most SMEs preferred to do social lending, such fundraising from their friends or relatives. Moreover, they turn to borrow money from illegal lending companies and have to afford high and unreasonable interest rates. Due to narrow financing channel in China, SMEs are hard to survive once there are some emergent financing gap.

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<sup>159</sup> Ibid.

<sup>160</sup> Frederic S. Mishkin, *The Economics of Money, Banking and Financial Markets* (Pearson Education, 2015), 24–29. “...In direct finance, borrowers borrow funds directly from lenders in financial markets by selling them securities (also called financial instruments), which are claims on the borrower’s future income or assets...” “...indirect finance because it involves a financial intermediary that stands between the lender-savers and the borrower-spenders and helps transfer funds from one to the other...”

In other words, without enough financial support, they are vulnerable and less-competitiveness during operating their business. To bridging the gap of financial lending for SMEs, P2P lending works as social lending agencies to supply the strong capital demand of SMEs in China. P2P lending provide a short-term loan and quick procedure for SMEs to help them solve their lack of cash flow. Until 2015, the amount of P2P Lending market in China is estimated to be more than \$92.07 billion<sup>161</sup>.

Although P2P lending provide a new financial channel for SMEs raising funds, there are still many platforms of P2P lending platforms going into bankruptcy. In other words, without appropriate financial regulation, the quality of operation among these platforms exist a huge gap and the investors benefits cannot be protected. In early 2015, China Banking Regulation Committee reorganize their committee and create new subsidiary department, called the Department of Inclusive Finance<sup>162</sup>. The role of this department deals with the industry of P2P Lending in China. However, compared with current legislation process of the United States and the United Kingdom, the financial regulation of P2P Lending in China is still at a trial period, it is an urgent issue to borrow foreign experiences and provide legislation to balance lending efficiency and investors benefits in China.

In addition to perspective from borrowers of P2P lending market, the demand from investors is also an important and crucial factor leading to rapid growth in Chinese P2P lending market. The recent literature<sup>163</sup> has indicated that there are two crucial factors which includes structure of family

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<sup>161</sup> Bryan et al., "Harnessing Potential."

<sup>162</sup> *Bringing Finance to the Masses: How Online Peer-To-Peer Lending Is Transforming China's Financial Landscape*, (Merics, March 26, 2015)."

<sup>163</sup> Yang Tao (杨涛), *The Real Peer-to-Peer Lending: Innovation, Risk and Supervision* [真实的 P2P 网贷：创新、风险与监管] (Beijing: Economy & Management Publishing House, 2016), 61–62.

property in China, and interaction between deposit rate and inflation rate of Chinese market. First, as shown in Figure 11, compared with the structure of family property in western countries, such as the United States and Europe region, the portion of deposit in Asian countries is relatively high, especially China, which is more than 70%. Based on this statistics, P2P lending provides alternative investment channel in Chinese market.

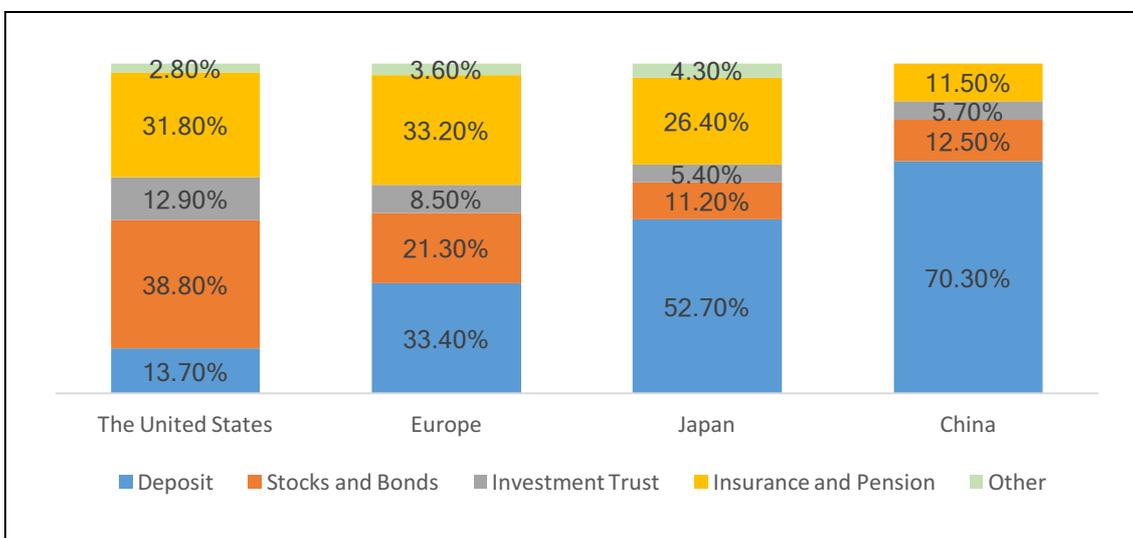


Figure 11: Structure of Family Property of the US, Europe, Japan, and China in 2015

Source: *The Comparative Study of Funds Flow among Japan, the United States, and European Countries*, (Bank Of Japan, December 22, 2016). *Structure of Family Property in China*, (Daiwa Institute of Research, March 1, 2013). The statistics of China in 2015 cannot be accessed. Accordingly, the data of China is based on 2011. This figure is constructed by the author.

Besides, as shown in Figure 12, despite the deposit rate in China was quite stable at 3 % from 2012 to 2014, but the inflation rate was significantly high relative to the deposit rate. Understanding the real interest rate is important, for example, if takes inflation rate into consideration, the real interest rate in 2011 is minus, -1.9%. Even though the real interest rate from 2012 to 2014 was positive, it only flows from 0.4% to 0.75%. In other words, it may enhance motivation of investors

in China for investing their idle fund for pursuing high reward in capital market rather than only depositing in bank. Both structure of family property in China and interaction between deposit rate and inflation rate of Chinese market explains the motivation from investors and its interaction with P2P lending in China.

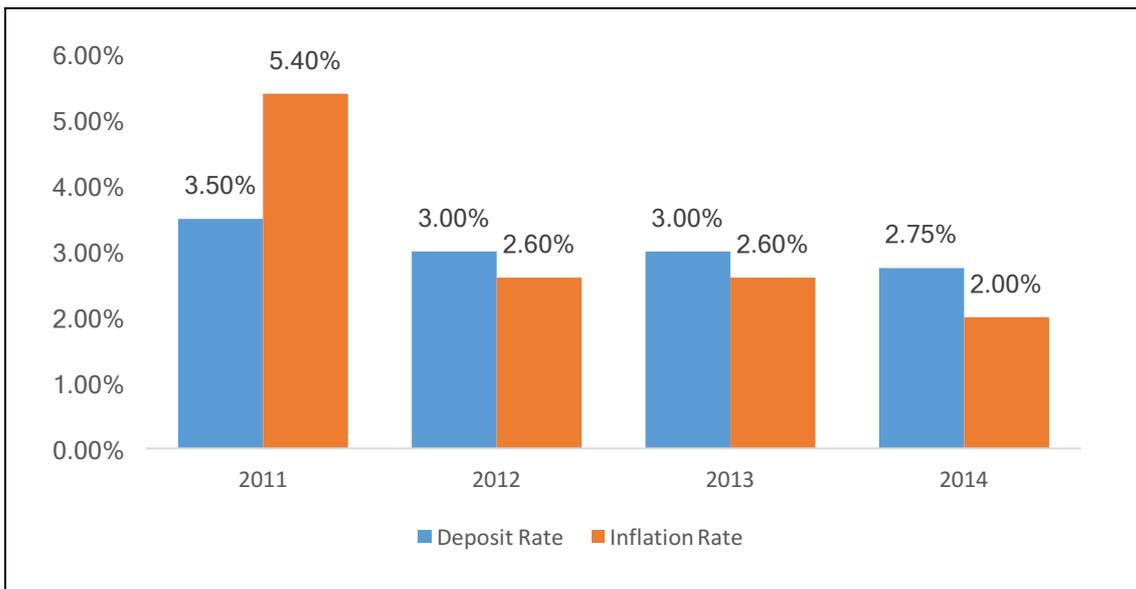


Figure 12: The Deposit Rate and Inflation Rate from 2011 to 2014 in China

Source: The World Bank, “Deposit Interest Rate,” Market Information, *The World Bank*, (July 11, 2016). This figure is constructed by the author.

### 3.2.2. Hard-Law Perspective: From Gradualism to Shock Therapy

#### 3.2.2.1. Stage 1 (2007-2011): Build a firewall for isolation

PaiPaiDai, the first P2P lending platform in China, was established in 2007. Nonetheless, P2P lending does not raise awareness by China Banking Regulatory Commission (CBRC) until 2011.

CBRC issued *Notice of the General Office of China Banking Regulatory Commission on Warning of*

*Risks Associated with Peer-to-Peer Lending*<sup>166</sup>, a notice for informing banks identifying risks of P2P lending and establishing firewall against illegal behavior caused by P2P lending platforms.

In this notice, there are seven problems and risks of P2P lending industry in China should be awarded, including (1) P2P lending, as a mechanism of social lending, may influence the effect of economic policy provided by central bank, (2) the risks of embezzling funds of customers, (3) P2P lending platforms are lacking of ability evaluating credibility of borrowers, (4) reputation of banks may be damaged due to misleading advertisement by P2P lending platforms, (5) lack of financial regulation, (6) the risks of P2P lending are relatively higher than banks, (7) expand the scope of subordinated loan in China.

From the aforementioned content, there are three major risks, including (1) Economic Policy: the confliction with current financial system, (2) Legal Risks: criminal law, and (3) Instability of P2P lending platforms: trial stage and lack of financial experiences. The substantial policy of P2P lending was not shown in this notice. This notice is much more like a warning rather than providing legal framework. Despite the fact there is no any regulation effect toward P2P lending industry by this notice, it is the milestone that Chinese relevant authorities are trying to understand the industry of P2P lending for further policy development.

In stage 1, the attitude of relevant authorities in China is much more like building a firewall for isolating the industry of P2P lending instead of including P2P lending as a new financial institution. From the viewpoint of the notice issued by CBRC, it only tries to list risks of P2P lending in China

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<sup>166</sup> Notice of the General Office of China Banking Regulatory Commission on Warning of Risks Associated with Peer-to-Peer Lending [中國銀監會辦公廳關於人人貸有關風險提示的通知] (People's Republic of China|CN).

and prevent any business cooperation with bank rather than any concrete measure toward this industry.

### 3.2.2.2. Stage 2 (2011-2015): Portrait the border of P2P lending

In order to deter illegal fundraising criminal cases, Supreme People's Court, the Supreme People's Procuratorate and the Ministry of Public Security in China has issued opinions, *Opinions of the Supreme People's Court, the Supreme People's Procuratorate and the Ministry of Public Security on Several Issues concerning the Application of Law in the Handling of Illegal Fund-raising Criminal Cases*<sup>167</sup>, which also indicate four bottom lines of P2P lending industry. Hence, P2P lending platforms should ensure: (1) their role as intermediary agency, (2) not involving in any guarantee service, (3) not involving in capital pool, and (4) not illegally taking in deposits from the general public<sup>168</sup>. This research will provide a deep view of the four bottom lines as following parts.

P2P lending is originally the meaning of Peer-to-Peer lending or Person-to-Person lending. From this viewpoint, the role of P2P lending platform is working as an agency for bridging connection between borrowers and lenders. Specifically, an original model of P2P lending platform only provides information of loan rather than cash flow of borrowers and lenders. Nevertheless, in practice, it is difficult to match borrowers and lenders together because lenders normally prefer short term loan and small amount of loan. In order to attract lenders, P2P lending platform will divide a

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<sup>167</sup> Opinions of the Supreme People's Court, the Supreme People's Procuratorate and the Ministry of Public Security on Several Issues concerning the Application of Law in the Handling of Illegal Fund-raising Criminal Cases [最高人民法院、最高人民检察院、公安部关于办理非法集资刑事案件适用法律若干问题的意见] (People's Republic of China|CN 2014.3.25).

<sup>168</sup> "...一是要明确信息中介性质，二是要明确平台本身不得提供担保，三是不得归集资金搞资金池，四是不得非法吸收公众资金..."

long term loan as several short term loans and a huge amount of loan as several small amount loans for disguising risks. This measure will increase risks of a loan and mislead lenders. In this regard, Chinese authorities aim to define P2P lending as intermediary agency of loan.

In comparing with industry of P2P lending in other countries, Chinese P2P lending platforms normally provides guarantee service for ensuring that lenders will not lose their principal of loan or even interest. This measure is trying to enhance reliability of P2P lending for attracting more capital from immature lenders. Nonetheless, there is no guarantee that borrowers will definitely repay principal and interest on time. Without deposit insurance mechanism as bank, it is difficult to have a stable guarantee services of principal and interest of lenders. It is a mystery that a P2P lending platform having prosperity of a steady flow of principal and interest without any risks. Hence, this is the reason why a P2P lending platform should not be involved in any guarantee service.

As aforementioned, guarantee services are normally provided by a P2P lending platforms in China. In order to cover bad debts for ensuring principal and interest, some of P2P lending platforms in China try to (1) forge borrowers, (2) alter the amount of real loan, (3) alter the term of real loan, and (4) encourage lenders of P2P lending depositing fund for auto-bidding of P2P loan.

Consequently, P2P lending platforms will have certain amount of capital for creating a false impression that P2P lending is quite promising since they have surely received principal and interest in the beginning. In this regard, it is obvious that there is no match between borrowers and investors. Conversely, the principal and interest of certain cases is repaid by other loan borrowers or victims of fake loan projects. In order to prevent addressed issues as above, a P2P lending platform should not be involved in capital pool.

In most jurisdiction, it is forbidden to take in deposit from the general public without permission or license. According to Article 176<sup>169</sup> Criminal Law in China, it is illegal and has criminal liability for doing business of deposit without permission. From this viewpoint, authorities indicated their worries of P2P lending becoming illegal fraud companies rather than Fintech industry. Though it seems there are four different bottom lines of this notice, they are coherence and surrounded with same core direction, which is ensuring the business of P2P lending in China is only working as an intermediary agency without involving in any case flow.

In stage 2, comparing with stage 1, relevant authorities in China is no longer isolating P2P lending industry by building a firewall but aware the necessity of addressing P2P lending promptly, which shows the importance of P2P lending in China. The characteristic of policies in stage 2 is trying to define P2P lending in China as an information agency rather than financial institution. The measure of achieving aforementioned goal is preventing a P2P lending platform from involving cash flow between borrowers and lenders.

### 3.2.2.3. Stage 3 (2015-): Excluding disqualified platforms

On 18 July 2015, *Guiding Opinions on Enhancing Positive Development of Internet Finance*<sup>170</sup>, which are guiding opinions regarding internet finance have been issued by central government in China, which define the business model of P2P lending as information agency rather than engaging

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<sup>169</sup> Article 176, Criminal Law of China, “Whoever illegally takes in deposits from the general public or does so in disguised form, thus disrupting the financial order...”

<sup>170</sup> Guiding Opinions on Enhancing Positive Development of Internet Finance [关于促进互联网金融健康发展的指导意见] (People’s Republic of China|CN 2015.7.28).

any activities relating to accumulating capital from general public for investment<sup>171</sup>. Based on aforementioned guiding opinions, consultation paper of interim measures regarding P2P lending has been issued on 28 December 2015. After discussion for several months, *Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Institutions*<sup>172</sup>, have been finally announced on 24 August 2016. The interim measures include eight chapters with 47 articles, including five major perspectives regarding regulatory framework of P2P lending in China.

As shown in Table 18, first, the business model of P2P lending is defined as an agency providing loan information for bringing borrowers and lenders together<sup>173</sup>. Second, the interim measures cap the annual transaction amount of each investor. Each P2P lending borrower only could raise 200,000 CNY in a P2P lending platform and 1 million CNY in all platforms annually<sup>174</sup>. Legal person is 1 million CNY and 5 million CNY separately<sup>175</sup>. Third, major activities of P2P lending should be conducted through virtual channel<sup>176</sup>, such as internet, phone call, mobile, and so forth. Namely, physical channel for business activities of P2P lending is basically forbidden. Fourth, cash flow between borrowers and lenders should deal by bank rather than the P2P lending platforms<sup>177</sup>. Fifth, relevant information, such as borrowers, loan, and risk evaluation, should be disclosed

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<sup>171</sup> “...a P2P lending platform should be within the business scope of information agency providing loan information between borrowers and lenders. A P2P lending platform should not provide any credit service as well as illegal accumulating capital from general public...” (...个体网络借贷机构要明确信息中介性质，主要为借贷双方的直接借贷提供信息服务，不得提供增信服务，不得非法集资...)

<sup>172</sup> Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Institutions (People’s Republic of China|CN 2016.8.24).

<sup>173</sup> Article 2, Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Institutions

<sup>174</sup> Article 17

<sup>175</sup> Article 17

<sup>176</sup> Article 16

<sup>177</sup> Article 28

prominently on the website of the P2P lending platform<sup>178</sup> as well as reported to financial authorities<sup>179</sup>.

Table 18: Overview of P2P Lending Regulation in China

Type	Content	Regulation
Business Model	Information agency	Article 2, 3
Cap Amount of a Borrower	Natural person: 200,000 CNY / 1 million CNY  Legal person: 1 million CNY/ 5 million CNY	Article 17
Business Activities	Principal: Virtual Channel  Exception: Physical Channel	Article 16
Cash Flow	Cash flow between borrowers and lenders should be dealt by bank rather than a platform	Article 28
Disclosure Duty	Relevant information should be prominently disclosed on the website and reported to financial authorities	Article 30, Article 31

Source: This table is constructed by the author.

The interim measures clearly distinguished the business model between P2P lending and banking industry. Compared with banking industry, P2P lending companies provide information of loan matching borrowers and lenders directly rather than accumulating capital from general public. In addition, the transaction amount of P2P lending is defined as small scale loan. In addition, P2P lending companies are only allowed to operate their business on the Internet rather than face to face service as financial institution. Moreover, cash flow between borrowers and lenders is going through

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<sup>178</sup> Article 30

<sup>179</sup> Article 31

bank rather than a P2P lending platform. Therefore, P2P lending is a supplement role of capital market rather than a replacement of banking industry.

### 3.2.3. Soft-Law Perspective: Independence, Neutrality & Transparency

#### 3.2.3.1. Historical Development in China

Business association is a common organization in most countries in the world. However, it is relatively not as usual in most socialism countries, such as Soviet Union, East Europe, and China before. In order to achieve the goal of planned economy under concept of socialism, most socialist governments normally manage enterprise in direct way without business association as intermediary agency<sup>180</sup>. China, as a typical socialism country before, had share similar policies in their history though it has developed rapidly and transit into capitalism after Chinese economic reform in 1978. Consequently, this Dissertation found that the development of business association in China could be divided into two major parts which includes before Chinese economic reform in 1978, and the reestablishment of business association after 1978.

The origin of business association in China could be traced back to Zhou dynasty (B.C. 770 – 476). Merchants in same industry normally gather together in certain area for doing business, which is known as “Si (肆)”. Because of geographical relation, they have more opportunity to gather together and make decision easily. Relatively matured business association has been developed around the period of Sui dynasty and Tang dynasty in China, which is known as “Hang (行)”. The main roles of “Hang” are restricted competition, and public relationship with government. In this

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<sup>180</sup> Shi Jingxing (石景星), *The Theory of Business Association* [行业协会概论] (Shanghai: Fudan University Press, 1989), 75.

regard, the business association in history tried to protect and maximize benefits of members against outsiders.

After 1949, Chinese Communist Party was mostly dominant the role of self-regulation body in China. Federation of Industry and Commerce (工商联) are established across the country. The role of Federation of Industry and Commerce is taking over existing business associations. Taking the development of Shanghai as an example, existing business associations were gradually taken over from 1949<sup>181</sup>. Until 1958, most business associations established before 1949 already merged into state-owned enterprise and Federation of Industry and Commerce. In other words, most business associations in China were internalized under government structure rather than self-regulation from the start of socialism in China.

Without business association, the management of state-owned enterprise in China mainly and highly relied on bureaucratic system and a series of administrative measures<sup>182</sup>. This managing system was criticized<sup>183</sup> for a few reasons including lack of efficiency, over-regulation, and the burden of government is too heavy. Specifically, it is overload that business associations all merged into government. In this stage, Chinese government tried to merge business association across the country for integration. Based on this integration, they want to implement their planned economy policy in a comprehensive and effective way. From the discussion, this study found that business association has developed for many years in China as other countries. However, it has dramatically and fundamentally changed after 1949, when China started to implement socialism and the function of business association is taken over by governments at separate levels.

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<sup>181</sup> Ibid. at 46–48.

<sup>182</sup> Ibid.

<sup>183</sup> Ibid. at 76–78.

After Chinese economy reform in 1978, Federation of Industry and Commerce in China at different level of municipalities started to reestablish business association as auxiliary measures supporting their new economy policy<sup>184</sup>. This is a milestone for development of business association in China since there is only one formal business association before 1978, which is Federation of Industry and Commerce<sup>185</sup>. The period of Chinese economy system's transformation could be roughly divided into two periods, which are initial phase (1978 – 1992) and deepening phase (1993 – until now)<sup>186</sup>. With development of economy transformation in China after 1978, the business associations also rapidly developed and had different functions in aforementioned periods correspondently.

In the initial phase, most business associations are government-driven. The fact of established business associations are strongly effected by government policy<sup>187</sup>, including (1) most budget of business associations are from government, (2) most staff of business associations are government officials, and (3) most members are state-owned business. Because power of appointment and budget are highly controlled by government, the autonomy power of associations in this phase are not effective. In other words, Chinese business associations in this phase were more likely working as an auxiliary organization without substantial function. And most business associations in China

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<sup>184</sup> Jing Xiaocheng (金晓晨), *The Legal Mechanism of Business and Industry Association* [商会与行业协会法律制度研究] (Beijing: China Plan Press, 1989), 11–22.

<sup>185</sup> Tang Yunyi (汤蕴懿), *Industry Association and Its Mechanism* [行业协会组织与制度] (Shanghai: Shanghai Jiao Tong University Press, 2009), 125–26.

<sup>186</sup> Yu Hui (余晖), *Industry Association and Its Development in China: Theories and Cases* [行业协会及其在中国的发展：理论与案例] (Beijing: Economic & Management Publishing House, 2002), 51.

<sup>187</sup> Ibid.

are established by Chinese government, which is a top-down structure rather than bottom-up. Hence, some of business associations still substantially are controlled by governments<sup>188</sup> in practical.

Based on the above discussion, this research found some characteristics of business association developing in China. First, business association was almost not existed and merged into governments due to socialism policy in China. Second, the mechanism of business association was reestablished after economic transformation in 1978. Third, the autonomy power of business association was not functionalized because of budget and appointment mostly controlled by government in the beginning stage of reestablishment. Fourth, motivations from market competition led business association in China gradually having their substantial function instead of organization in name only. Despite the reestablishment of business association from 1978, the influences of budget or appointment by government still remain in contemporary development of leading business association in varying degrees across industries.

#### 3.2.3.2. Independence: Top-Down Structure

As the experience of self-regulation in the UK is regarded as a relatively successful model for developing regulation of P2P lending, there are some literature<sup>189</sup> discussing possibility of introducing this system into China. National Internet Finance Association of China (NIFA, 中国互联网金融协会) has been established in March 2016. NIFA is regarded as a self-regulation association, which is dedicated to collaborating the whole industry of Internet Finance and providing self-regulation rules as supplement of existing financial regulation. Nonetheless, the essence of self-

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<sup>188</sup> Tang, *Industry Association and Its Mechanism*.

<sup>189</sup> Guo, "Industry Association in China and Self-Regulation of P2P Lending."

regulation association is collaboration of whole industry for developing common rules instead of power extended from government sectors. Without independence from government, the rules may not be properly represent the opinions from industry and the core of self-regulation is lost.

### 3.2.3.3. Neutrality of Structure: Low Coverage Rate

In the following part, this Dissertation selects Beijing P2P Association as an example for analyzing the structure among its members, which is shown in Table 19. The reason is that Beijing P2P Association has set up disclosure duty as mandatory obligation of their members and also publish this information on the Internet for evaluation of P2P lending users, which share similarity with P2PFA in the UK. Based on the following analysis, this study tries to conclude its common and differences between Beijing P2P Lending Association and P2PFA in the UK.

Table 19: The Members of Beijing P2P Lending Association

Currency Unit: million CNY

No.	Company Name	Average Interest	Market Shares <sup>190</sup>	Amount
1	yinhuwang	15.04%	0.06%	1,392.96
2	yilongdai	10.16%	1.19%	26,215.03
3	xinyongbao	11.77%	0.10%	2,136.60
4	hexindai	13.84%	0.08%	1,874.39
5	huaguojinrong	10.00%	0.02%	396.10
6	yinkewang	8.13%	0.12%	2,732.73
7	jinlianchu	10.26%	0.05%	1,179.59
8	datonghang	10.96%	0.00%	57.27

<sup>190</sup> Market Shares = History Cumulative Transaction Amount of a P2P Lending Platform / History Cumulative Transaction Amount of Whole P2P Lending in China

9	anrunjinrong	-	-	-
10	yixin	-	-	-
11	youliwang	-	0.35%	7,730.78
12	puhuilicai	9.74%	0.00%	109.53
13	aiqianbang	9.96%	0.04%	778.53
14	jiuyijinrong	-	-	-
15	jinronggongchang	8.68%	0.08%	1,693.73
16	Jimuhezi	-	-	-
17	baocaiwang	-	0.04%	833.97
18	wangxinlicai	-	-	-
19	Licaifan	10.60%	0.11%	2,468.23
20	Aiqianjin	11.90%	0.42%	9,353.33
21	rongbeiwang	10.43%	0.03%	669.31
22	1818pingtai	-	-	-
23	guangxindai	14.39%	0.03%	595.92
24	minxindai	-	-	-
25	hengyirong	12.20%	0.51%	11,185.35
26	Jioufu	-	-	-
27	Jingjinsou	9.03%	0.01%	146.36
28	yitongdai	13.28%	0.10%	2,281.00

Source: This table is constructed by the author.

As shown in Table 19, firstly, the membership coverage rate of whole industry based on total transaction amount is around 3.34%, which does not have enough influential power of whole industry after almost two years. Compared with statistics in the UK, the coverage rate of P2PFA is more than half in the beginning. Theories of self-regulation has pointed out that the lack of comprehensive coverage rate is a cortical issue of industry self-regulation. Therefore, it is quite challenging for their further development of covering the whole industry.

Secondly, the largest market shares are YingLondDai (翼龙贷), which is 1.19%, and the smallest is PuHuiLiCai (普惠理财), which is almost 0%. There are two characteristics which includes (1) there is no any member having portion of market scales more than 5%, and (2) the market scales among members are also diversified. This may answer why the coverage rate between P2PFA in the UK and Beijing P2P Lending association has a huge gap. Specifically, each founder of P2PFA has more than 15% market scale in the beginning and the founder of P2PFA are top 3 player among the industry. Nonetheless, this does not show same practice in Association in Beijing.

Thirdly, from the average interest rate of P2P loan among members of Beijing P2P Lending Association, this study found that the highest average interest rate of P2P loan is 15.04% by YinHuWang (银湖网) and the lowest one is 8.13% by YinKeWang (银客网). Generally, the average interest rate of a P2P lending platform could show its potential risks. There are eight members of Beijing P2P Lending Association. Their average interest rate is higher than whole industry average rate. There is no correspondent statics in the UK which could be as comparison. The motivation of disclosure duty may be different among all members. Specifically, platforms with lower risks may be more willing for complying with disclosure duty and platforms with higher risks may be less interested in because the default rates of their loans may be higher than average.

#### 3.2.3.4. Lack of Transparency

P2P Lending was firstly introduced in China in 2007. And the first industry self-regulation entity, ZhongGuanCun Internet Finance, was established in 2013. From 2013 to 2016, there are approximately 22 industry self-regulation entities in China separated by national level, province level, and prefectural level. As shown in Table 21, P2P lending association were separately

established 2 in 2013, 6 in 2014, 11 in 2015, and 3 in 2016. If we compare with the amount of problematic P2P lending platforms, there is relevance. It is estimated that problematic platforms were around 4 in 2012, 71 in 2013, 255 in 2014, 748 in 2015, and 361 in 2016.

Table 20: The Relevance of Self-Regulation and Industry Crisis

Year	Number of Association	Problematic P2P Lending Platform	Note
2012	-	4 ↗	-
2013	2 ↗	71 ↗	-
2014	6 ↗	255 ↗	-
2015	11 ↗	748 ↗	-
2016	3 ↘	361 ↘	Regulation is enacted on August, 2016

Source: This table is constructed by the author.

As shown in Table 21, one association is government-based in national level, six associations were organized by both government and industry, and 15 platforms are mainly founded by industry rather than intervention from government. Based on previous analysis of relevance between self-regulation and industry, this research tries to answer the question that why the number of P2P lending association is increased when problematic P2P lending are more and more. As indicated in this part, there are 15 platforms are organized by industry, which take 68% of whole industry. At first glance, it seems that P2P lending industry is quite self-regulated because of its voluntary membership. However, this Dissertation has also found that there are nine platforms, which were members of P2P lending associations, had been defined as criminals because of embezzling customer funds.

Based on this viewpoint, this study has found that some of industry self-regulation may be built as a “certificate generator” instead of committing integrity. Specifically, it is necessary to prove to public that P2P lending platforms are members of some associations for showing its credit. Nevertheless, Ezubao, the largest fraud of P2P lending in China was also a member of ZhongGuanCun Internet Finance. From this viewpoint, though there are 22 associations in P2P lending market, it still remained huge gap among these associations.

Table 21: Industry Self-Regulation of P2P Lending in China

G: Government

I: Industry

National Level				
Name	Date	Background	Web	Problems
National Internet Finance Association <sup>191</sup>	Mar. 2016	G	V	
Province Level				
Name	Date	Background	Web	Problems
GuangDong Internet Finance	May. 2014	G+I	V	3
JiangSu Internet Finance	Dec. 2014	G+I	V	-
JiangXi Internet Finance	Dec. 2015	-	X	-
FuJiang Internet Finance	Dec. 2015	-	X	-
FuJiang Internet Finance and Information	Dec. 2015	I	X	-
GuanXi Internet Finance	Jan. 2016	I	X	-
Prefecture Level				
Name	Date	Background	Web	Problems
Beijing P2P Lending	Dec. 2014	I	V	-
Shanghai Internet Finance	Aug. 2015	G+I	V	2
GuanZhou Internet Finance	Apr. 2015	G+I	V	1
ShenZheng Internet Finance	Jul. 2015	I	V	-

<sup>191</sup> 39 P2P lending platforms as members among 437 members. 16 P2P platforms are board members.

ShenZheng Internet Finance Business	Sep. 2015	I	X	-
DongGuang Internet Finance	Jun. 2014	I	V	-
HangZhou Internet Finance	Sep. 2015	I	X	-
Xiamen Internet Finance	Sep. 2014	G+I	X	-
GuiYang Internet Finance	Nov. 2014	I	X	-
WuHang Internet Finance	Mar. 2015	I	X	-
ChangSha Internet Finance	May. 2015	I	X	-
NanChang Internet Finance	Dec. 2015	I	X	-
Other Level				
Name	Date	Background	Web	Problems
LuJiaZui Internet Finance	Mar. 2016	G+I	X	-
ZhongGuanCun Internet Finance <sup>192</sup>	Aug. 2013	I	V	3
Chinese Internet Finance	Nov. 2013	I	X	-

Source: This table is constructed by the author.

#### 3.2.4.Lack of Co-Regulation

The industry of P2P lending is mainly regulated by Chinese government. Though NIFA is an association, it should be regarded as extension of regulatory power from government sectors rather than voluntary industry association. Within the scope of voluntary industry association of P2P lending, it shares some common characteristics of the UK, such as trying to gather P2P lending platforms for developing rules. However, compared with the UK, Chinese association of P2P lending is more like to pursue as elite members club. With the membership of P2P lending association, members are believed as trustworthy and reliable companies, which is beneficial for expanding their business scale. However, there is no objective or visible criteria for selecting these companies. Through obtaining membership, they do empower and prove their credit to investors.

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<sup>192</sup> Ezubao, the largest fraud of P2P lending, was a member.

And only few platforms could be selected and have membership. Consequently, there is limited room for industry association working as supplement role co-regulating P2P lending industry with financial authorities.

### 3.3. Analysis and Reflection

First, based on above statistics, this research found that there is no dramatically change from 2005 to 2012 in terms of annual total amount of cases and loan in British P2P lending industry shown in Figure 10. From this viewpoint, as shown in Table 22, it could be understood that (1) there is no self-regulation association established before 2011 because of tiny market scale; and (2) it is necessary and meaningful for establishing association in 2011 due to relevant regulation is issued in 2014. The transaction amount was apparently increased after 2012. Moreover, the groups of borrowers and lenders were diversified, which means the coverage of P2P lending users are increasing rapidly. And disputes among borrowers, lenders, and P2P lending platforms are also estimated to have increased. As a result, the demand of dispute resolution from market is needed; (3) as there are around 70,000 cases of Zopa, a P2P lending platform in the UK, the industry of P2P lending is influential in finance sectors, which gradually developed rules.

Table 22: Some Phenomenon of P2P Lending Industry and its Caused Factors

Item	Phenomenon	Factors of Market
1	No self-regulation of P2P lending before 2011.	The market scale of P2P lending is tiny at that time.
2	Mechanism of P2P lending dispute resolution are needed.	The transaction amount was apparently increased after 2012.
3	The industry of P2P lending is gradually influential in finance sectors, which is required rules for regulation.	P2P lending has developed as a matured industry as a supplemental channel of fundraising as there is 70,000 cases on Zopa in 2015.

Source: This table is constructed by the author.

Second, the self-regulation has been practiced in the financial industry of the United Kingdom for many years, as well as the recent financial innovation, P2P lending industry. Though there are no mandatory requirements of participating association as a P2P lending platform in the United Kingdom, Peer-to-Peer Lending Financial Association (P2PFA), has covered eight major platforms<sup>193</sup> which represent 84.27% transaction amount of P2P lending industry<sup>194</sup> until July 2016. Moreover, members of P2PFA are required to disclose their transaction data publicly<sup>195</sup>, known as “Loan book”, which investors can easily track each historical transaction of loan by downloading files from websites of P2PFA members.

<sup>193</sup> Peer-to-Peer Finance Association, “Members,” Industry Association, *Peer-to-Peer Finance Association*, (July 11, 2016). Funding Circle, Landbay, Lending Works, LendInvest, MarketInvoice, RateSetter, ThinCats, and Zopa.

<sup>194</sup> AltFiNews, “AltFi Data Alternative Finance Volume Index - UK.”

<sup>195</sup> Peer-to-Peer Finance Association Operating Principles.

“...Platforms should publish full data on their loanbook... This is a loan by loan view of the portfolio of loans originated through the platform... The loanbook data must be updated at least monthly and consistent with the other data requirements...”

Specifically, from the perspective of developing process regarding P2P Finance Association (P2PFA) in the UK as shown in Figure 13, it could be divided into three steps. First, Zopa, Funding Circle and RateSetter, operating their business in the UK market for several years, organized P2P Finance Association, which is a self-regulation body. They developed some rules of self-regulation for pursuing high standards of conduct and consumer protection. Second, P2PFA conduct several conversations with Treasury in the UK for defining P2P lending and its relevant policy. Third, P2PFA was dedicated to keeping in touch with Financial Conduct Authority (FCA), which becomes the main authority of P2P lending industry in the UK for ensuring that the regime designed by FCA is suitable to this industry.

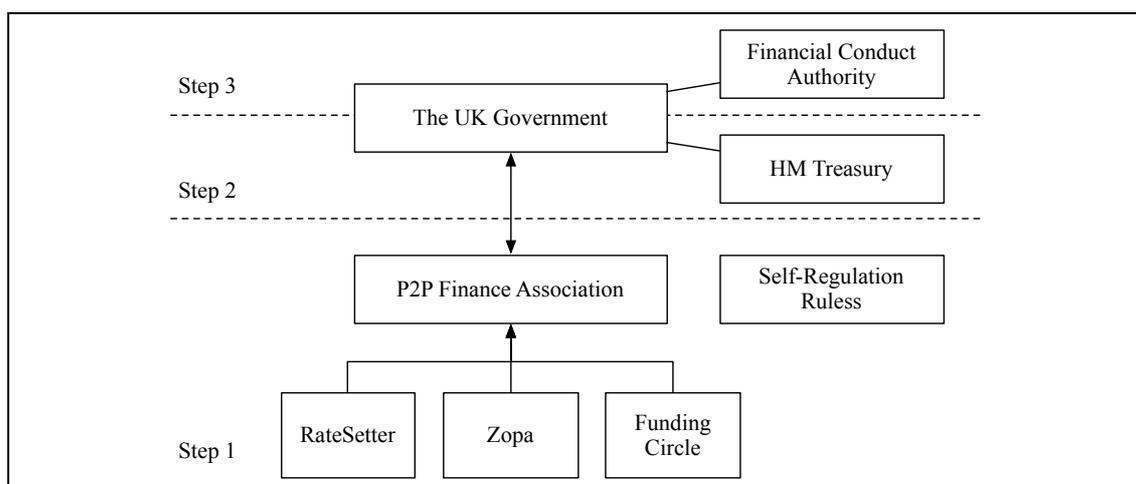


Figure 13: The developing process of self-regulation in the UK

Source: This figure is constructed by the author.

Third, from the regulatory perspective of P2P lending industry in the UK, it could be divided as three stages as shown in Table 23, which includes (1) Stage 1 (2005-2013): Portrait the border of P2P lending, (2) Stage 2 (2013-2014): Regulatory Consultation, and (3) Stage 3 (2014- ): Relevant Policy Support. In the stage 1, there is neither specific regulation nor forbidden policy toward P2P

lending industry. Hence, P2P lending has developed for several years from 2005. In order to enhance transparency of industry, P2P Finance Association has been established by industry. In stage 2, government started to take some measures toward P2P lending industry. This may be caused by lobby from P2PFA. In other words, industry is not passive role which regulated by government. Rather, it is much more like P2PFA trying to persuade government for establishing some regulation for enhancing their credit in society. In the last stage, policies of British government tried to have some auxiliary measures for supporting P2P lending industry, such as Tax benefits rather than strict regulation which provides P2PFA, a self-regulation body, more possibilities to develop their self-regulation rules.

Table 23: Relationship between Government and P2PFA

	Government	P2PFA (self-regulation)	Relationship
Stage 1 (2005-2013)	No specified regulation.	P2PFA was established in 2011.	Complementation
Stage 2 (2013-2014)	Relevant regulation is provided in 2014.	P2PFA also actively lobbies this regulation.	
Stage 3 (2014- )	Supporting policies	P2PFA has more possibilities of self-regulation rules	

Source: This table is constructed by the author.

From the economical perspective, the market scale of China is much larger than the transaction amount and number of platforms in the UK. It is hard to have industry association with consensus among few thousands platforms in China. P2PFA in the UK was originally established by major market players, which lead to their successful enforcement of self-regulation rules. However,

industry associations in China does not show similar characteristics. Besides, from the soft-law perspective, the development of industry association in China is at initial stage with strong power from government sectors. In addition, from hard-law and co-regulation perspective, the financial authorities have strong power to restrict the industry of P2P lending, which provides limited room of engagement of industry association. Accordingly, the soft-law role of industry association may not be easily implemented in Chinese market at this stage.

## Chapter 4 Credit Rating Agencies of P2P Lending in China

In previous chapter, this study has analysis of both hard-law and soft-law perspectives of P2P lending regulation in China and found that there still remains some difficulties of mitigating frauds caused by P2P lending industry in China. This Dissertation firstly points out that there is few or no remarkable effects of current policies by government. In addition, this study further compares industry association of P2P lending between the UK and China, which shows that the successful model in the UK may not be implemented into China at this moment. Is there any institution could be possible candidate if current rules provided by government and industry association could not have remarkable effects. This study suggests that CRAs of P2P lending industry in China may work as third party supervising P2P lending platforms for enhancing market transparency as their credit rating report may improve the issue of asymmetry information.

This research selects CRAs of P2P lending industry in terms of dealing with severe frauds of P2P lending in China with several reasons. First, there is no or few CRAs of P2P lending industry in the world, which could be regarded as a feature of Chinese P2P lending industry. Second, CRAs of P2P lending industry in China have wide coverage of P2P lending industry, which show their effect of industry. Third, CRAs of P2P lending industry have been developed for several years and compete each other, which shows its demand and necessity from Chinese market.

In other words, instead of “association-based” self-regulation, this dissertation explores possibility of alternative self-regulation model in Chinese P2P lending industry, which is CRAs. Wangdaizhijia, which is a credit rating agency of P2P lending industry in China. Wangdaizhijia is

founded in 2011, which is a portal website company offering P2P lending platforms for advertising their business and attracting potential investors. After several years of the development, it gradually serve as third party consultant for providing investors some objective data for evaluating the performance of P2P lending platform.

There are three major companies providing rating report of P2P lending platforms in China which includes Wangdaizhijia, P2PEYE, and Rong 360. Wangdaizhijia is an asset management company. P2PEYE and Rong 360 are registered as technic and information companies. However, none of them registered as credit investigation industry in China. The rating reports issued by these three platforms indicated that “The result of rating report is only for reference rather than investment advice<sup>197</sup>”. Further, Rong 360 states that “They do not have any liability of loss to investors<sup>198</sup>”. Both of above two statements try to prevent any potential liability. Nonetheless, if credit-rating agencies of P2P lending do substantially influence evaluating criteria of investors, disclaimer or statement probably should be rendered as void either in whole or part. In other words, this chapter explores the substantial market power toward investors of credit-rating agencies of P2P lending in China.

In addition to substantial market power toward investors, crediting-rating agencies of P2P lending also show their effect on rated P2P lending platforms, for instance, DuanRong, a P2P lending platforms has been rated as C and C- by Rong 360 on February and May 2015<sup>199</sup>. However,

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<sup>197</sup> Wangdaizhijia [网贷之家], “The Rating of P2P Lending” [网贷之家], Market Information, 网贷之家, (July 11, 2016).

<sup>198</sup> Rong 360 [融 360], “The Rating of P2P Lending” [网贷平台评级], Credit Rating Report, 融 360, (July 11, 2016), 360.

<sup>199</sup> DuanRong [短融网], “The Notice of DuanRong versus Rong 360, a Case Regarding Unfair Competition and Reputation” [短融网关于起诉融 360 不正当竞争和名誉侵权的公告], P2P lending platform, 短融网, (September 9, 2015)..

DuanRong claimed that their performance was not as worse as the rating report published by Rong 360. In addition, Rong 360 has never accessed their transaction data for further assessment of their company. Therefore, DuanRong filed a suit based on *Anti-Unfair Competition Law*<sup>200</sup> because they argued that Rong 360 does not register as rating business and have no legal right for issuing rating report publicly<sup>201</sup>. It shows that rating report of P2P lending platforms has its effect on market. However, the entry requirement and liability of credit-rating agencies of P2P lending are still vague and necessary to be addressed.

The fundamental proposition of this chapter is that CRAs of P2P lending have shown its positive impact on Chinese P2P lending market by enhancing market transparency and reducing the situation of asymmetry information. Nonetheless, there are no sufficient measures limiting abuse of their discourse power, which may damage reputation of P2P lending platforms, mislead the decision made by investors, and so on. Following the above proposition, this chapter conducts analysis from theoretical, practical, empirical, judicial, and regulatory perspectives.

#### 4.1. Theoretical Perspective: Literature Review

The study of CRAs of P2P lending in China has acquired significance gradually until the first judicial case regarding CRAs of P2P lending at the end of 2015. The controversy over CRAs of P2P lending has received a great deal of attention in the media though there are still only a few academic discussions of this issue. Relevant academic discussions are developed but the scope of this dissertation is limited to three major parts, which are more relevant with analysis of soft-law

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<sup>200</sup> 反不正当竞争法 (Anti-Unfair Competition Law)

<sup>201</sup> DuanRong, “The Notice of DuanRong versus Rong 360, a Case Regarding Unfair Competition and Reputation.”

mechanism, which includes enhanced transparency of P2P lending market, lack of relevant regulation, and possibilities of corruption.

#### 4.1.1. Enhancing Disclosure Duty of P2P Lending Market

Zhou states that there are three major characteristics of CRAs<sup>203</sup>, which could be further developed and beneficial in P2P lending industry in China, including investor normally is generally lack of profession and time for evaluating risks of P2P lending platforms, the opinions provided by CRAs could assist investors to make decision of P2P investment, and P2P lending platforms would be more self-regulated with opinions issued by CRAs. Dong<sup>204</sup> claims that CRAs of P2P lending has successfully pointed out risks of a P2P lending platform as Rong 360 has ranked Ezubao at worst rank (C-) before Ezubao was alleged as perpetration of largest frauds of P2P lending in China. The example addressed by Dong may support the statement of Zhou that CRAs could enhance self-regulation of P2P lending as it detects risks in advance as in the case of Ezubao.

#### 4.1.2. Lack of Relevant Regulation

Huang<sup>205</sup> asserts that CRAs could improve transparency of P2P lending industry in China, which could enhance reliability of P2P lending industry. However, Huang further states that CRAs of P2P lending should not be regarded as CRAs in tradition. The services of CRAs of P2P lending are more like an evaluation report of a P2P lending platform. Deng<sup>206</sup> also shares same viewpoints and states that CRAs of P2P lending is out of scope of current regulation of CRAs in convention.

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<sup>203</sup> Zhou, "The Mechanism of Credit Rating and Its Support on P2P Lending," 62.

<sup>204</sup> Zhi et al., "Who Owns the Power of Credit Rating of P2P Lending?," 96–97.

<sup>205</sup> Ibid. at 97.

<sup>206</sup> Deng, "The Necessity of Credit-Rating Agency in P2P Lending: Based on First Case of Credit-Rating of P2P Lending," 113–14.

Consequently, it is not necessary to apply any license to operate business of CRAs in P2P lending.

Both Huang and Deng view CRAs of P2P lending in a positive way and out of regulatory scope of traditional CRAs.

#### 4.1.3. Possibilities of Corruption

Pu<sup>207</sup> contends that CRAs should not involve any direct or indirect relation with a P2P lending platforms as it may decrease their trust and neutrality. Huang further indicates that CRAs may have relation with a P2P lending platform under a certain condition, for example, CRAs could charge the rating fee from a P2P lending platform. However, such business relation should be disclosed in public. Deng supports disclosure duty and further indicates that behavior of CRAs of P2P lending could be restricted by reputational mechanism. Although both Pu and Huang agree that the relation between a platform and CRAs of P2P lending should be avoided, Huang has suggested that disclosure duty could be introduced for preventing the concern of objectiveness of CRAs.

#### 4.1.4. Summary

Based on the above discussion, this dissertation found that the significance of CRAs in Chinese P2P lending industry has gained in gradual as most scholars state that CRAs of P2P lending enhance transparency of a P2P lending platform to some extent. The concern of interest conflict has also been addressed many times. In spite of a series of exploratory academic discussions above, it is necessary to understand business model of credit rating agency in Chinese P2P lending industry.

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<sup>207</sup> Zhi et al., “Who Owns the Power of Credit Rating of P2P Lending?,” 96–97.

#### 4.2. Practical Perspective: Analysis of Business Model

CRA refers to those companies giving credit rating of debt market, stock market, financial products, such as Moody's Investor Service, Standard & Poor's, and Fitch Ratings, which is normally license-based or regulated in most jurisdictions. Credit rating system was established in main municipal cities as a part of internal sector of The People's Bank of China, and Central Bank in China. The first independent credit rating agency, Fareast Credit, was established in 1988. Though credit rating system had acquired attention of regulatory authorities in 1988, the market of CRAs was emerged after the regulatory policy, *The Notice of the State Council on Promoting the Macroeconomic Management of Securities Market*<sup>208</sup> issued by central government in 1992, such as some of current leading CRAs, Shanghai Brilliance Rating and Dagong Credit were established in 1992 and 1994. After several years of development, central government of China had further issued a notice, *Some Opinions of the Standard of Credit Rating Service for Enterprise Bond*<sup>209</sup> for confirming nine certified CRAs for providing services of rating cooperate bond in China.

The concept of CRAs of this Dissertation is much more broader and not limited to regulated or licensed agencies. Instead, any person or agencies intend to provide credit rating or similar opinions are under the scope of discussion in this part. CRAs are more like abstract concept rather than specified to companies regulated by relevant regulation of credit rating. Hence, the coverage of CRAs in following discussion is pretty wide, including person, academic institution, traditional credit rating agency, and CRAs of P2P lending.

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<sup>208</sup> 国务院关于进一步加强对证券市场宏观管理的通知 (People's Republic of China|CN 1992).

<sup>209</sup> 关于中国诚信证券评估有限公司等机构从事企业债券信用评级业务资格的通知 (People's Republic of China|CN 1997).

#### 4.2.1. Person: Yifei

##### 4.2.1.1. Background

Yifei is a P2P lending investor. He started to express his opinions of selected P2P lending platforms in China from February 2012. In the beginning stage (February 2012 – March 2013), he did not provide quantitative rating report. He normally selects around 10 P2P lending platforms (9-12 platforms) and give comments on each platform based on his experience and some statistics provided by P2P lending platforms or CRAs of P2P lending. In order to provide relatively objective opinions of selected P2P lending platforms, Yifei had introduced a point-based system for his opinions and ranking of platforms<sup>210</sup>.

##### 4.2.1.2. Criteria

From April 2014 to December 2014, the rating report is published bimonthly and it has become monthly report from 2015. His blog has been visited 462,916 times. His rating report has also been published on many online communities<sup>211</sup> of P2P lending, which shows that the actual coverage may be more wide. Credit rating report provided by Yifei consisted of 10 items of index, which could be further classified into three perspectives: (1) internal factors (loan project quality); average interest rate, average loan term, average loan amount (2) external factors; the number of monthly active investors, the number of monthly active borrowers, monthly transaction amount, and the increasing rate of transaction amount (3) subject opinions toward a platform reputation, transparency, and service quality. The point range of each item is from 0-10.

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<sup>210</sup> YiFei [羿飞], “The Five Star Ranking System of P2P Lending” [网贷五星评级], credit rating report, *Sina*, (July 15, 2013).

<sup>211</sup> Online community of P2P lending established by Wangdaizhijia and P2P Eye.

#### 4.2.1.3. Ranking

As a result, the total point range of a platform is from 0 to 100. The rating range of credit rating report provided by Yifei includes 8 ratings, which are 5 star (1<sup>st</sup>-5<sup>th</sup>), 4.5 star (6<sup>th</sup> – 10<sup>th</sup>), 4 star (11<sup>st</sup>-15<sup>th</sup>), 3.5 star (16<sup>th</sup>-20<sup>th</sup>), 3 star (21<sup>st</sup>-30<sup>th</sup>), 2.5 star (31<sup>st</sup>-40<sup>th</sup>), 2 star (41<sup>st</sup>-50<sup>th</sup>), and 1 star (50<sup>th</sup>-). From the above criteria, the rating provided by credit rating report of Yifei is a relative but not absolute rating system.

#### 4.2.2. Academic Institution: Chinese Academy of Social Sciences

##### 4.2.2.1. Background

Chinese Academy of Social Sciences is a higher education institution in China, which is also a think tank of Chinese central government. In order to enhance the stability of P2P lending, Chinese Academy of Social Sciences had worked with The People's Bank of China, and China Banking Regulatory Commission as a research team for gathering information of P2P lending platforms for understanding the risks of this industry. The research team has selected 104 P2P lending platforms from 2,000 platforms. There are several factors of aforementioned selected criteria, including the registered capital is more than 10 million CNY; the platform has operated more than a year; the platform is still operating; and the information disclosed by the platform is relatively transparent.

##### 4.2.2.2. Criteria

There are four major indicators for evaluation. Firstly, the transaction amount of a P2P lending platform, the amount of receivables, registered capital, and any relevant factors of debt paying ability. Secondly, the cost of technology, the amount of borrowers, the amount of investors, and any

relevant factors of stable transaction. Thirdly, the legitimacy of relevant contracts or any relevant possible factors of frauds and bankruptcy. Fourthly, amount of customers, transaction amount, receivables within 80 days, and any relevant factors of their cash flow.

#### 4.2.2.3. Ranking

The ranking of 104 P2P lending platforms is based on four indicators, credit risks, operation risks, legal compliance risks, and liquidity risks, which is further calculated and represented in both hundred-mark system and alphabetical letters grade. The best ranking of the P2P lending platform is 89 (AA+) and the worst ranking is 48 (B-). The rating provided by credit rating report of Chinese Academy of Social Sciences is both shown in a relative and absolute rating system.

#### 4.2.3. Traditional Credit Rating Agency: Dagong Credit

##### 4.2.3.1. Background

Dagong Credit is a CRA established in 1994, which has long history among credit rating industry in China. They have published rating reports toward sovereign debt and also debt market in China. On January 2015, Dagong Credit published two rating reports of P2P lending industry, including “The Blacklist of P2P Lending Industry in China” and “The Warning List of P2P Lending Industry in China”. Compared with other rating reports of P2P lending, the one published by Dagong credit is shown in negative list way rather than positive list. Namely, the listed P2P lending platforms are selected as Dagong Credit. And Dagong Credit found there are some potential risks of these P2P lending platforms.

#### 4.2.3.2. Criteria

The standard of blacklist is based on “Dagong Credit Internet Finance Credit Risks – Blacklist Guideline<sup>212</sup>”. There are eight major standards of blacklist which includes: (1) Without or over relevant permission, provide the service of internet finance illegally (2) The disclosure duty is not complied, or there remain severe concerns of the disclosed information regarding to its authenticity, comprehensiveness, promptness, and so on (3) Contrary to relevant regulation provided by financial authorities, such as establishing capital pool illegally, and frauds caused the damage of their investors (4) The platform is established for illegal purpose, such as illegal pooling deposit, illegal fund-raising, and money laundering (5) Any behavior relates to breaking the law (6) The risks of a platform are severe (7) A platform in warning lists, which is getting worse than ever before (8) Any other relevant credit risks should be taken into consideration.

Moreover, the criteria of warning list on the basis is “Dagong Credit Internet Finance Credit Risks – Warning Guideline<sup>213</sup>”. There are 11 major criteria of warning list including: (1) the relevant disclosure duty is insufficient or remains concern of its authenticity; (2) capacity to repay remains concerns; (3) the risks management is not stable enough to continue their business model; (4) difficulties for investors to withdraw their investment; (5) the failure of investment; (6) the liquidity is getting worse; (7) the asset is restructured, which may cause damage of investors; (8) under investigation of relevant authorities; (9) involved in judicial case, which may cause the impact on

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<sup>212</sup> Dagong Credit [大公信用数据有限公司], “Dagong Credit Internet Finance Credit Risks – Blacklist Guideline” [大公互联网金融信用风险 黑名单管理办法], Credit Rating Agency, 大公信用数据有限公司, (January 21, 2015).

<sup>213</sup> Dagong Credit [大公信用数据有限公司], “Dagong Credit Internet Finance Credit Risks – Warning Guideline” [大公互联网金融信用风险 预警观察名单管理办法], Credit Rating Agency, 大公信用数据有限公司, (January 21, 2015).

their further business; (10) the risks of bankruptcy; (11) any other relevant credit risks should be taken into consideration

Most factors of blacklist relate to the issues of breaking relevant regulation and also severe technology risks. The standard of warning list is about the issues of stability of a P2P lending platform, including business model, disclosed information, and legal compliances. In other words, a P2P lending platform on the blacklist is mostly already illegal under current regulation in China and a P2P lending platform on the warning list is likely under the grey zone. Based on the result provided by Dagong Credit on January 2015, there are 266 P2P lending platforms listed on the blacklist and 676 platforms on the warning list among 1,395 selected platforms in China. The amount of blacklist and warning list rates among samples are up to 67.5%.

#### 4.2.3.3. Ranking

The credit rating reports provided by Dagong Credit do not list the ranking of their blacklist and warning list. Specifically, there is no any different level among rating reports they issued. Nonetheless, the credit rating reports still divide its sample into two aspects, including blacklist and warning list. The blacklist is worse than warning list as most selected P2P lending platforms on blacklist may already be involved in some illegal activities, which are not allow in China.

#### 4.2.4. Credit Rating Agencies of P2P Lending

##### 4.2.4.1. Background

Wangdaizhijia and Rong 360 (融 360) were established in 2011. P2P Eye (网贷天眼) later commenced their business in 2013. Wangdaizhijia and P2P Eye publish their rating report every

month and the frequency of credit rating report issued by Rong 360 is every season. These three rating companies have accessed the materials for rating through public information and the data accessed from the rated P2P lending platforms.

#### 4.2.4.2. Criteria

As shown in Table 24, there are eight major factors of selected platforms for rating by Wangdaizhijia including: (1) the platform should be founded more than three months (2) the average amount of per borrowers should under the registered capital (3) loan loss provision, or 0.5\*registered capital of its bonding company (4) monthly investors should be over 100 persons (5) monthly borrowers should be over 5 persons (6) the annual interests rate should be under 18% or monthly interest rates should be under 1.5% (7) there is no criminal investigation within 3 months; the business is not forbidden by relevant regulation; relevant information should be easily accessed.

There are four factors of Rong 360 which includes: (1) the platform should be established more than 6 months (2) the average interest rates within three months should be under 24% (3) there is no any illegal activities within three months; relevant information should be easily accessed. In contrast, there is only one factor of selected platforms for rating by P2P Eye that is the platform should be established more than 3 months.

Table 24: The Criteria of Selected Platforms for Rating

	Wangdaizhijia	P2P Eye	Rong 360
Duration	3 months	3 months	6 months
The capability to repay for investors	V	-	-
Minimum of monthly investors	100	-	-
Minimum of monthly borrowers	5	-	-
Annual interests rate	18% (monthly 1.5%)	-	24% (within last 3 months)
No criminal investigation	Last 3 months	-	-
Contrary to law	Last 3 months	-	Last 3 months
Information Accessibility	V	-	V

Source: This table is constructed by the author.

#### 4.2.4.3. Ranking

The ranking provided by Wangdaizhijia is shown in hundred-mark system. P2P Eye in both hundred-mark system and alphabetical letters grade. Rong 360 in alphabetical letters grade. There are 100 P2P lending platform are selected for rating by Wangdaizhijia every month. Additionally, there are monthly 70 P2P lending platforms are chosen by P2P Eye. And around 100 platforms are rated by Rong 360 every season.

#### 4.2.5. Additional Information

Compared with government-driven mechanism of Chinese CRAs, Wangdaizhijia was voluntarily founded by private company without any intervention of relevant authorities in China, which could be regarded as market-driven. Chinese Academy of Social Sciences had also published rating report in 2014. P2P Eye, Rong 360, Dagong Credit, and Central University of Finance and Economics also issued rating report of P2P lending industry in 2015.

This study found that the business models of Rong 360, Wangdaizhijia, and P2P Eye are quite diversified as shown in Table 25, for example, the above CRAs of P2P lending normally generated their profit by working as a portal website for increasing access rates of certain companies, providing consultation and training service, and fund sales, which do not have any direct connection with rating fee provided by a rated company based on their official statement.

The institution providing credit rating reports of P2P lending, such as Dagong Credit and Chinese Academy of Social Sciences, also do not have any issue of interest conflict, for instance, Dagong Credit is a tradition credit rating agency and Chinese Academy of Social Sciences is an academic institution. Both institutions have their own core business, their credit rating reports of P2P lending are not their major services for profits. Moreover, the credit rating report provided by Chinese Academy of Social Sciences may come from their research grant. Nevertheless, this study fails to explain and analyze the credit rating reports provided by Yifei as they do not provide any information regarding their business model.

Table 25: Business Model of Major Credit Rating Agencies of P2P Lending in China

	Business Model for Profits
Rong 360	<ol style="list-style-type: none"> <li>1. Provide a portal website for increasing access rates of financial institutions</li> <li>2. Work as an agent to provide loan solution to a customer</li> <li>3. Advertisement fee of certain financial product</li> </ol>
Wangdaizhijia	<ol style="list-style-type: none"> <li>1. Advertisement fee</li> <li>2. Donation</li> <li>3. Provide the service of an establishing P2P lending platform</li> <li>4. Fund sales (Touzhijia)</li> <li>5. Provide the service of consulting and training</li> <li>6. Foundation fund</li> </ol>
P2P Eye	<ol style="list-style-type: none"> <li>1. Advertisement</li> <li>2. Donation</li> <li>3. Fund sales (Touyouquan)</li> </ol>
Dagong Credit	Credit Rating Business is its core business.
Chinese Academy of Social Sciences	Chinese Academy of Social Sciences is a governmental research institution. The research grant may be from government.

Source: This table is constructed by the author.

The study has briefly overviewed the background, criteria, and ranking method of six major credit rating reports of P2P lending in China, which could be further categorized as (1) person, (2) academic institution, (3) traditional credit rating agency, and (4) CRAs of P2P lending. This research found that credit rating reports are no longer issued by traditional rating company. Instead, there are plenty of rating companies that only provide their rating in P2P lending industry, which show the profession of this industry. Furthermore, the amount of credit rating reports also shows its importance in Chinese P2P lending industry as there remains huge gaps among thousands of P2P lending platforms, especially there are so many fraud platforms which are not easily distinguished.

Moreover, as shown in Table 26, the frequency of credit rating reports also show its demand from investors of P2P lending in China.

Table 26: The Overview of Major Credit Rating Agencies of P2P Lending in China

Category	Name	Start Date	Frequency
Person	Yifei	Feb. 2012	Monthly
Academic Institution	Chinese Academy of Social Sciences	Apr. 2015	Yearly
Traditional Credit Rating Agency	Dagong Credit	May. 2015	Only 1 time
CRAs of P2P Lending	Wangdaizhijia	Aug. 2013	Monthly
	P2P Eye	Aug. 2015	Monthly
	Rong 360	Feb. 2015	Quarterly

Source: This table is constructed by the author.

Nonetheless, the criteria among credit rating industry of P2P lending are still vague and necessary for further development as there is no clear criteria of their evaluation standard, for example, Wangdaizhijia has eight criteria for excluding inappropriate platforms selected to their rating reports while P2P Eye only provided one factor for achieving the same goal, which show the gap among this new industry. And there is a few explanations of evaluating procedure and decision making process disclose by CRAs of P2P lending industry. From this viewpoint, the CRAs may remain concerns of insufficient transparency, for example, the relationship between CRAs of P2P lending and a rated P2P lending platform are not clarified and disclosed yet, which may have negative effects on its objectiveness. Though credit rating agency is an agent between a P2P lending platform and a P2P lending investor, the transparency should be required. Otherwise, the

establishment of credit rating agency may not reduce information asymmetry but increase agent cost of this industry.

#### 4.3. Empirical Perspective: Based on Survey of P2P Lending Investors

In spite of a series of exploratory academic discussions has been conducted as well as overview of business models as above, there is no any empirical evidences or statistics a least shown to support their standpoints mostly. It is necessary to have a study understanding how CRAs of P2P lending has shown its impact on P2P lending industry. Accordingly, this Dissertation has further conduct following study for achieving the goal.

##### 4.3.1. Research Finding

###### 4.3.1.1. Awareness

Seventy-one percent of all respondents of this survey<sup>214</sup> have known the industry of CRAs of P2P lending in China as shown in Figure 14. With this viewpoint, CRAs of P2P lending have shown its impact on general public in China, which show the potential of CRAs as alternative regulatory measure toward Chinese P2P lending.

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<sup>214</sup> Appendix 2

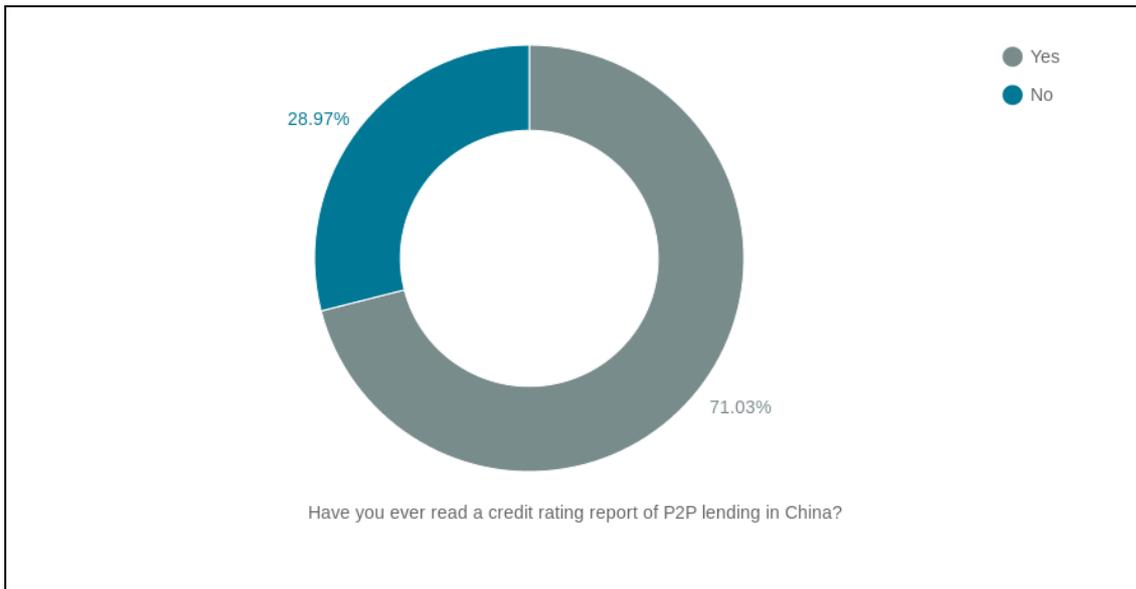


Figure 14: The Market Familiarity of Credit Rating Report of P2P Lending in China

Source: This figure is based on Appendix 2 (Question 1) and constructed by the author.

#### 4.3.1.2. Oligopoly

Although there are seven major credit rating reports of P2P lending in China, most of market share are currently distributed by two main rating companies, which are Wangdaizhijia (39.47%) and Rong 360 (34.87%) as shown in Figure 15. The third one is published by Chinese Academy of Social Sciences, a Chinese higher education institution, which only shares 8.55%. Therefore, the market of CRAs of P2P lending in China may be regarded as oligopoly. A rating report of P2P lending published by traditional well-known credit rating agency, Dagong Credit, also only share a little portion, which is 7.89%. From this viewpoint, reputational institution in China does not show their impact on P2P lending industry. And startups, such as Wangdaizhijia and Rong 360 are more attractive.

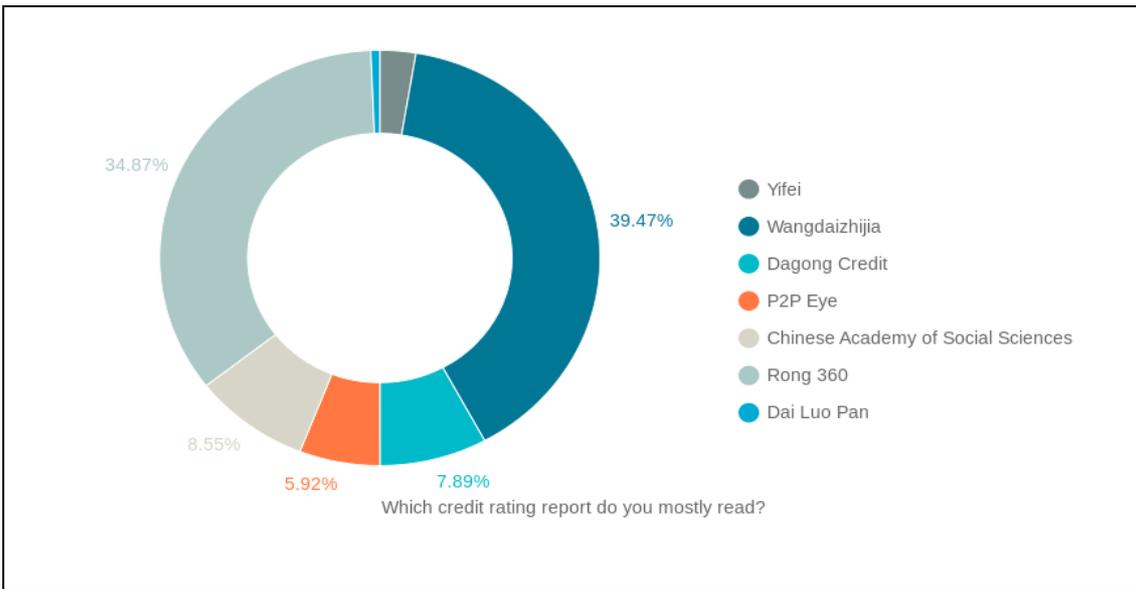


Figure 15: The Market Share of Credit Rating Report of P2P Lending in China

Source: This figure is based on Appendix 2 (Question 3) and constructed by the author.

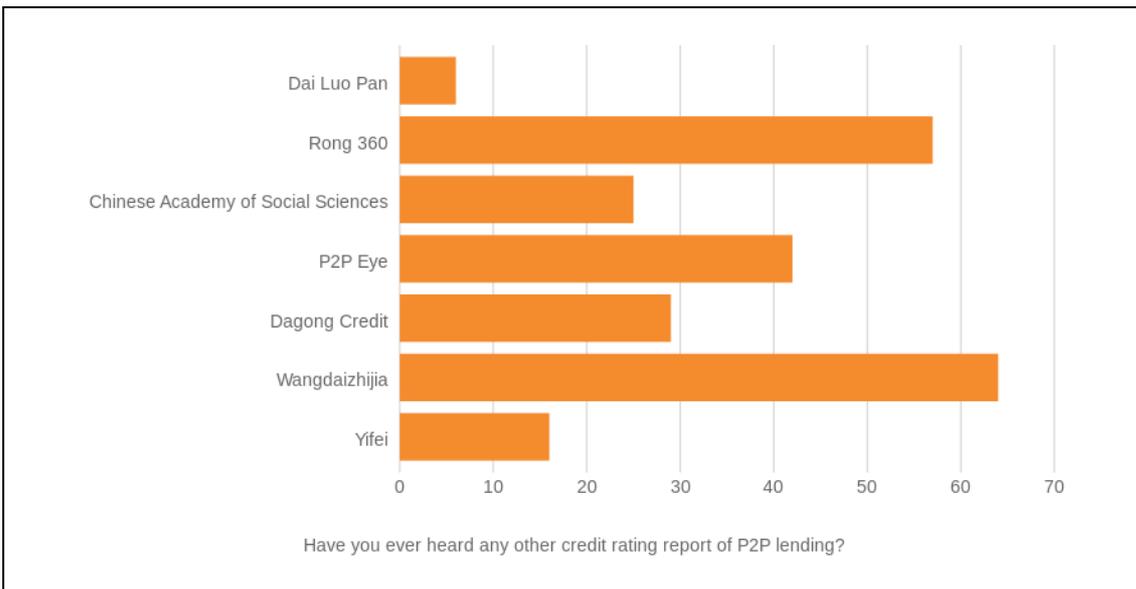


Figure 16: The Market Share of Credit Rating Report of P2P Lending in China

Source: This figure is based on Appendix 2 (Question 4) and constructed by the author.

#### 4.3.1.3. Investment Criteria

In order to understand the impact of CRAs of P2P lending for investors in China, this study has designed a question with multiple choices for analyzing tendency of evaluation criteria of P2P

lending investors. As shown in Figure 17, this study found that 57.89% of respondents who have experience of P2P lending investment are relying on disclosure information provided by P2P lending platform. 48.68% justify targeted investment of P2P lending through the grapevine, such as recommendation from family, and friends. Another 44.74% made decision of their investment via credit report provided by CRAs of P2P lending. This research also found that around 25% evaluated the potential target of investment by their intuitive judgment. Consequently, this Dissertation has refined the top three investment criteria of P2P lending investor, which are disclosure information, grapevine, and credit rating report issued by CRAs of P2P lending. The result does show that credit rating report of P2P lending has impact to some extent for Chinese P2P lending investors.

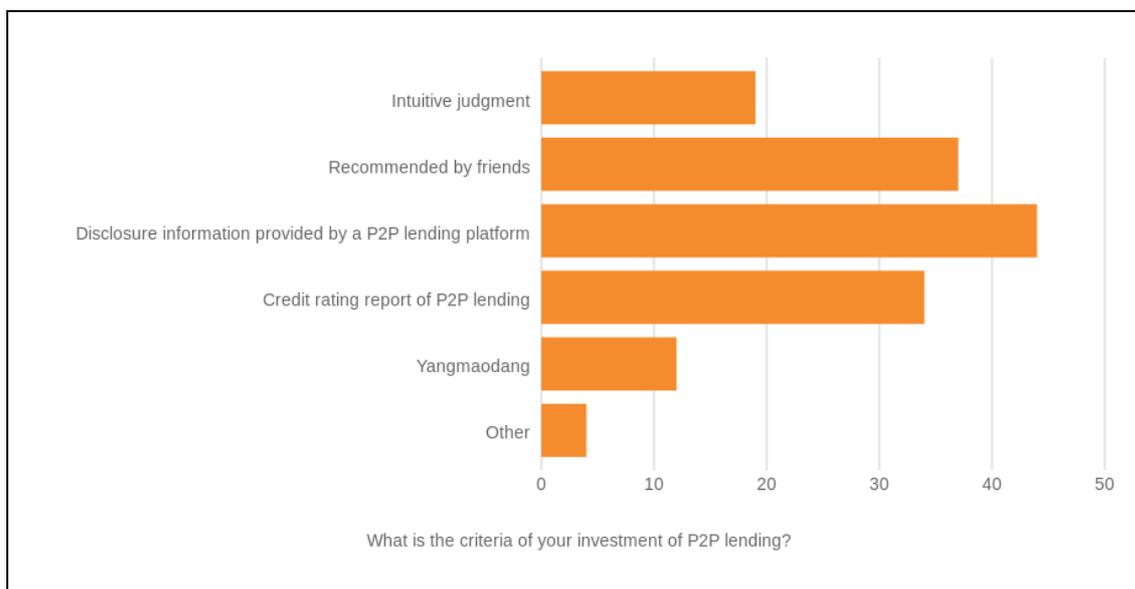


Figure 17: The Criteria of P2P Lending Investment in China

Source: This figure is based on Appendix 2 (Question 8) and constructed by the author.

#### 4.3.1.4. Diversified Utilities

This study has further followed up the question for understanding how credit rating report improved their judgement of P2P lending investment as shown in Figure 18. 94.74% of all respondents with experiences of P2P lending investment agree that credit rating report of P2P lending improved their evaluation of P2P lending investment. Based on this result, this questionnaire also tried to figure out what kind of concrete benefits for them in reading credit rating report of P2P lending by a question with multiple choice. 61.84% of above participants claim that credit rating report has contributed to them for better choosing suitable targeted investment, for example, they could easily understand whether it has high risks with high interest or low risks with low interest. In other words, they could make a portfolio of their P2P lending investment in an efficient way. Besides, 55.26% of above respondent state that a P2P lending platform with high ranking on credit rating report indeed does well. And 51.32% believe that credit rating report could help them prevent risky platforms as a warning function. The above reasons could be refined as objective evaluation criteria, subjective evaluation criteria, and warning lists. Hence, this study found that the credit rating report of P2P lending has diversified utilities for P2P lending investors in China.

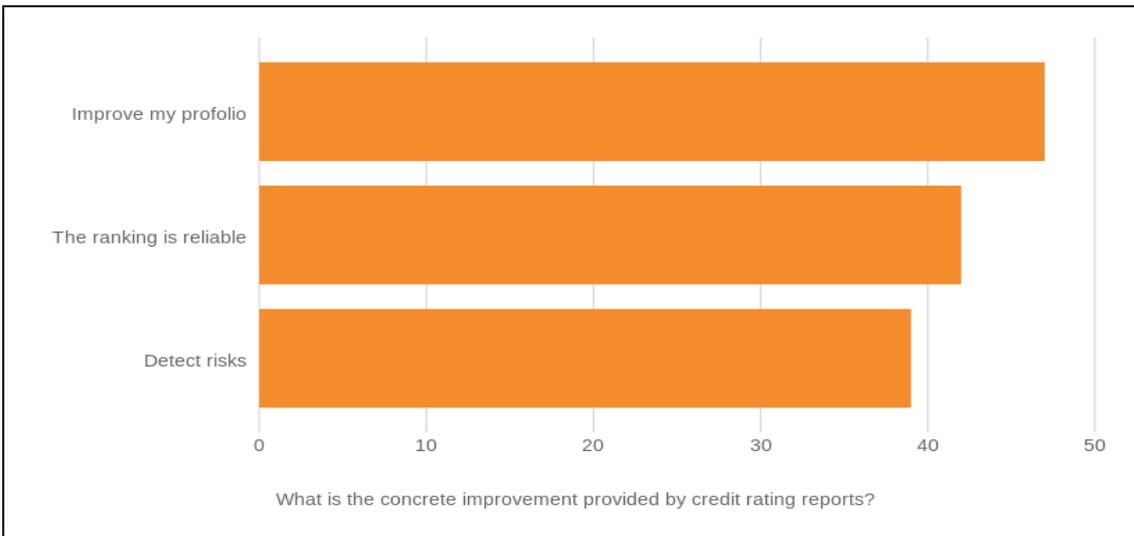


Figure 18: The Improvement Provided by Credit Rating Reports

Source: This figure is based on Appendix 2 (Question 10) and constructed by the author.

#### 4.3.1.5. Attitudes toward Credit Rating Report

This questionnaire has also asked respondents the credibility of credit rating report of P2P lending in China as shown in Figure 19. 5.26% of all respondents with investment experiences of P2P lending highly trust the credit rating report of P2P lending. The portion of trust is 50%. And opinions of another 38.16% of respondents is normal. Accordingly, 93.42% of P2P lending investors hold positive attitude toward credit rating report of P2P lending in China. And rest of respondents, 6.58%, held opinions of distrust. From above result, this research found that credit rating report of P2P lending in China has established their reputation to some extent, which may be regarded as potentiality for further development as auxiliary regulatory measure for P2P lending industry in China.

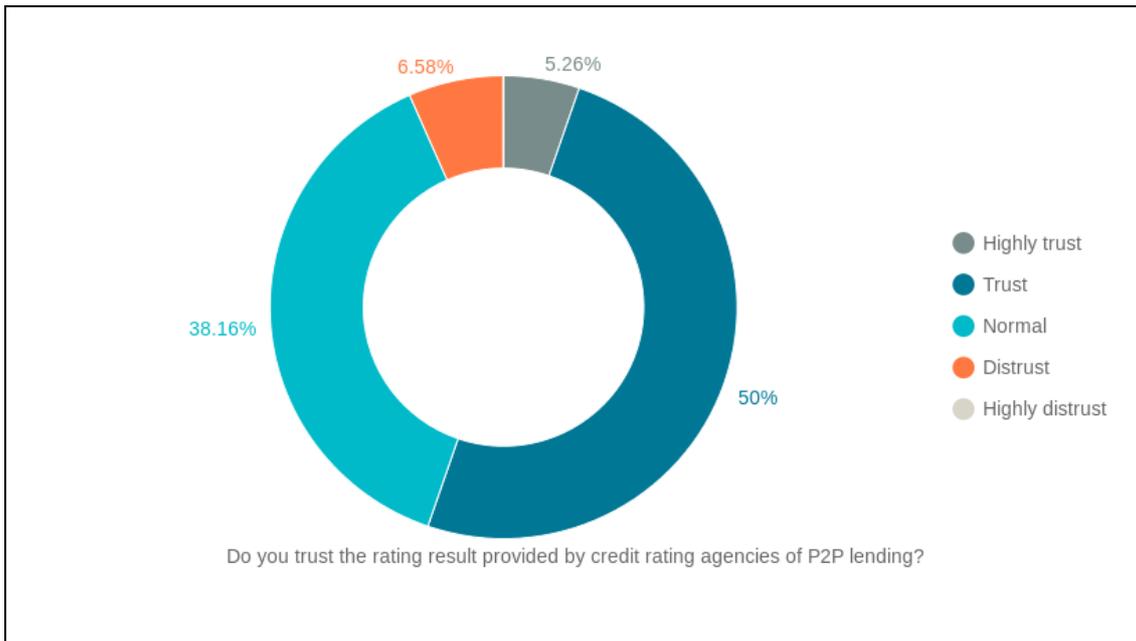


Figure 19: The Reliability of Credit Rating Reports of P2P Lending among Investors

Source: This figure is based on Appendix 2 (Question 11) and constructed by the author.

#### 4.3.1.6. Major Risks

Although the study found that most P2P lending investors have positive attitude toward credit rating report of P2P lending in China, there are plenty of negative news of CRAs of P2P lending in China on the Internet. Namely, there remains huge gap between the research results of this study and opinions provided by mass media. There are some concerns, including mass media amplify the negative news of this industry, and the sample of this study does not large enough for representing whole opinions. In order to prevent bias of previous finding that only 6.58% held negative opinions, this study also lists some negative opinions of all respondents with experiences of P2P lending investment based on risks of CRAs in tradition and also some negative news provided by mass media in China.

Therefore, as shown in Figure 20 and Figure 21, there are eight selected options for participants of this survey including: (1) ratings shopping: as the business model of CRAs is normally issuer-pay

model, the interest conflict between issuer and CRAs is normally concerned by public (2) lack of scientific analysis: CRAs of P2P lending has been criticized as the analyzing procedure of credit rating is based on subjective judgement (3) adverse impact on non-client P2P lending platform: there are two concerns of adverse impact, including clients of CRAs get relatively higher rating, and non-clients of CRAs get relatively lower rating (4) split rating: the result of credit rating provided by different rating companies should be similar based on their scientific analysis in ideal condition. However, the literature have found that there remains a gap among rating issued by different companies;

(5) oligopoly with insufficient competition: CRAs, such as Moody's, S&P, and Fitch, have been criticized as they have own most market shares and lack of competition (6) lack of ability to detect risks: CRAs have been criticized a lot as they failed to detect risks in time, which further regarded as main cause of financial crisis in 2008 (7) instable rating: CRAs of P2P lending in China has been pointed out that their ranking of same platform sometimes has dramatically change in short period, which is not reliable (8) dishonesty: some CRAs of P2P lending in China has accused that they normally delete conflict rating when there is any P2P lending going bankruptcy for maintaining their reputation.

68.42% of all respondents agree that CRAs of P2P lending in China do not detect risks in time. In addition, 59.21% state that credit rating report of P2P lending is subjective and lack of scientific criteria. 46.05% claim that the phenomena of ratings shopping happens in the industry of CRAs of P2P lending. The above top three concerns of subscribers of credit rating report show their concern on three perspective including, utility, reliability, and corruption. These three concerns may lead to a vicious cycle as corruption and reliability may result in lack of utility. Based on above finding, this

Dissertation initially found some inadequacy of CRAs of P2P lending in China, which should be taken into account. Consequently, this dissertation will have further discussion for providing correspondent proposed solution in next chapter.

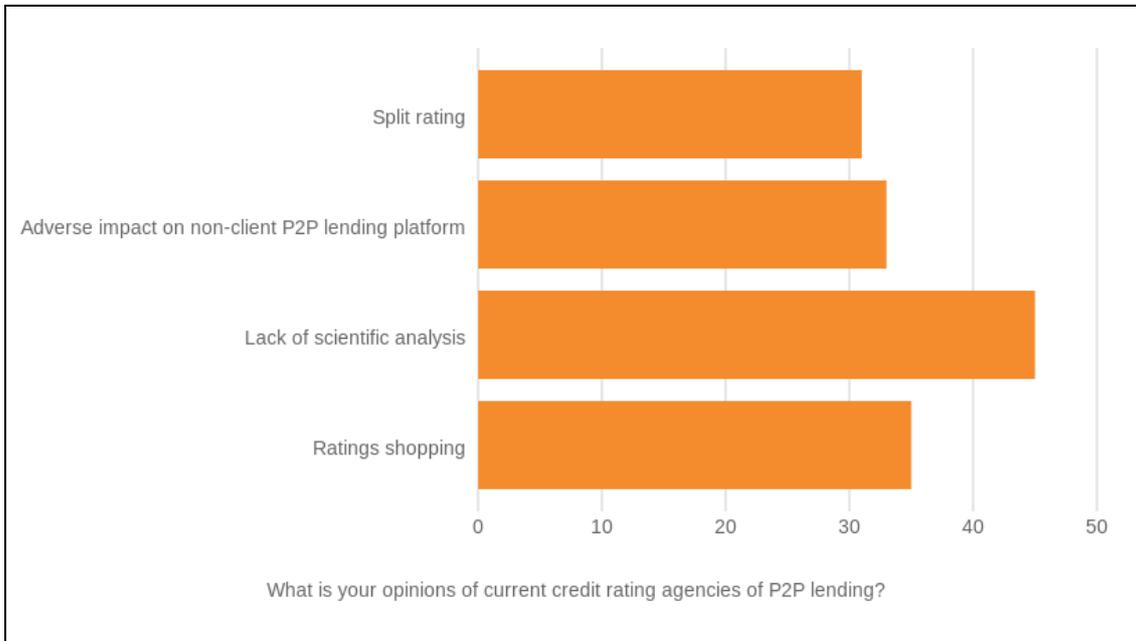


Figure 20: The Concerns of P2P Lending Investors on Credit Rating Agencies

Source: This figure is based on Appendix 2 (Question 12) and constructed by the author.

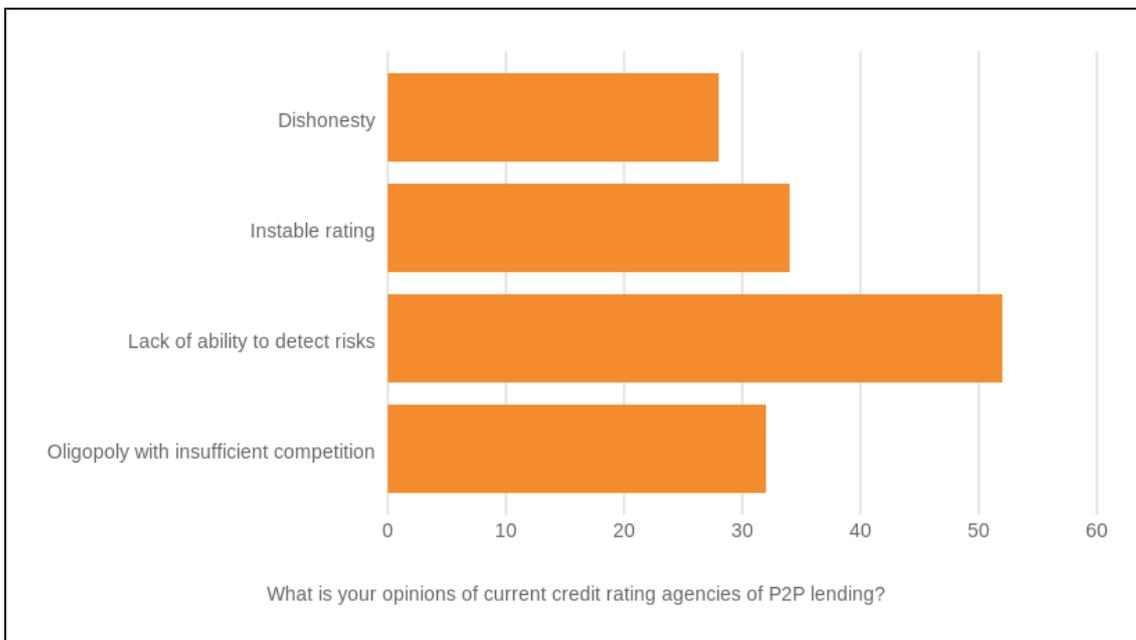


Figure 21: The Concerns of P2P Lending Investors on Credit Rating Agencies

Source: This figure is based on Appendix 2 (Question 13) and constructed by the author.

#### 4.3.1.7. Impact on Investment

In order to evaluate the impact of credit rating report of P2P lending in China, this study has asked participants whether credit rating report had impact on their P2P lending investment as shown in Figure 22. 15.79% of all respondents state that credit rating report of P2P lending had positive impact on their investment because the ranking of their investing P2P lending platform was upgraded. Moreover, 17.11% held the opinion that their P2P lending investment had been influenced by credit rating report as their investing platform was downgraded. 44.74% claim that there is no impact on their P2P lending investment by credit rating report. The other 22.37% do not show their opinion, which the option is “I don’t know”.

This study further asked respondents who believed their investment had been affected by credit rating report to indicate the name of platform for verification and confirming the impact of credit rating report on P2P lending report. Except of 9 invalid samples as they do not specify the name of affected P2P lending platform, there are 16 P2P lending platforms indicated by respondents. The above result from samples may be affected by subjective opinions of respondents as this study did not require respondents to point out cause and effect due to difficulty of providing such kind of evidence.

From above finding, this study found that 32.9% of respondents with experiences of P2P lending investment claim that credit rating report in China has impact either in a negative or positive way. Although this result does not show direct cause and effect between credit rating report and P2P lending platform, it does show the impact to some extent.

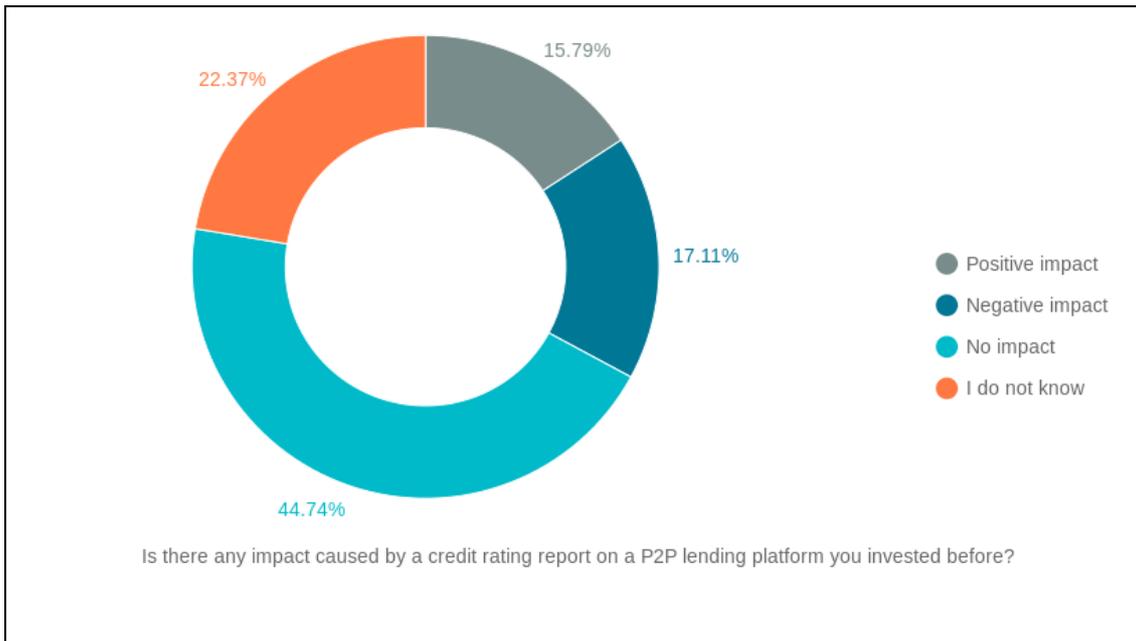


Figure 22: Credit Rating Reports and its Impact on a P2P Lending Platform

Source: This figure is based on Appendix 2 (Question 14) and constructed by the author.

#### 4.3.1.8. Concerns of Insufficient Transparency and Obscure Information

“Sunlight is said to be the best of disinfectants, electric light the most efficient policeman” has become the core concept of securities law for a century in the world, which was written by Louis D. Brandeis, a supreme court justice in the United States. It is common that a company listing on the stock market, having disclosure duty to show relevant information of itself, reducing asymmetry information between a company and its investors, which is beneficial to a company and investors as an investor could easily choose the target of investment and a company is easy to raise up capital if it is trustworthy.

However, this study has found that 76.32% of all respondents of this survey has claimed that the disclosure information of P2P lending platform is not transparent enough as shown in Figure 24.

Moreover, as shown in Figure 25, 73.68% stated that the information disclosed by a P2P lending

platform is generally obscure, which is not easy to understand for general public. Recently, in order to enhance transparency of a P2P lending platform in China, National Internet Finance Association, the government-driven association, has issued a guideline which require a P2P lending platform with membership to disclose 65 indicators in the near future. Although the above policy may lead the industry to be more transparent, there still remains room for improvement.

As this Dissertation found that around three quarters of respondents showed their concern about reliability and readability of disclosure information, it is necessary to establish a mechanism to reduce the difficulties, for example, the disclosure information of a company has normally examined and analyzed by accountant and then publish as a prospectus, which could reduce the difficulties of readability for general public. And rating companies in tradition has even just give simple rating for better understanding in efficient way. Hence, this study found that the current policy of disclosure duty of a P2P lending platform may need a third party with profession to enhance accessibility of disclosure information.

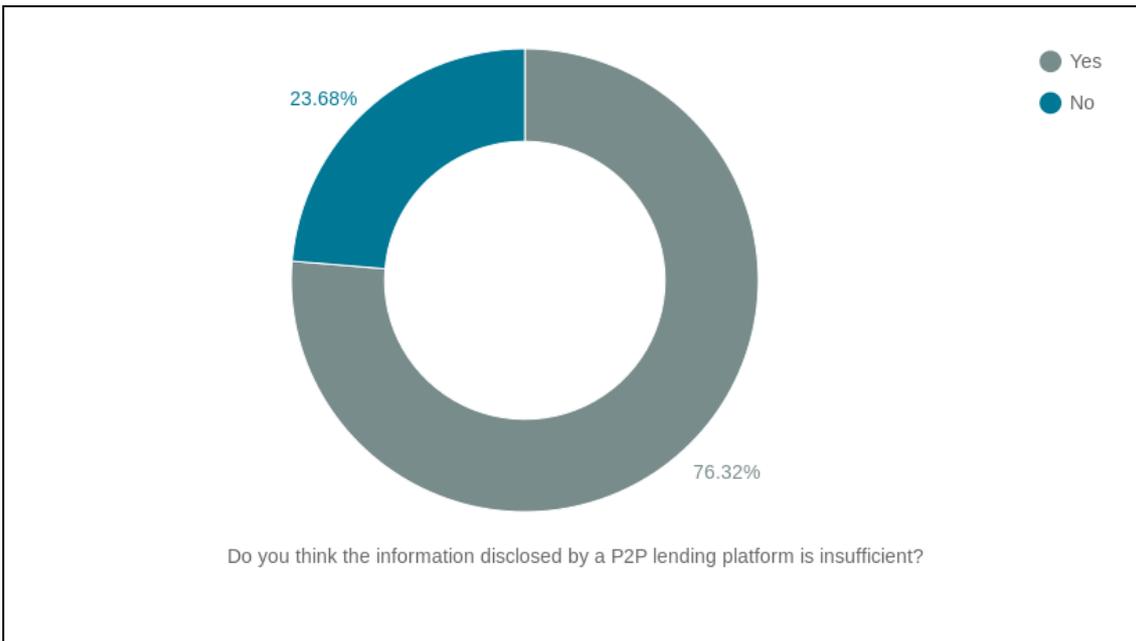


Figure 23: The Information Disclosed by a P2P Lending Platform and its Sufficiency

Source: This figure is based on Appendix 2 (Question 16) and constructed by the author

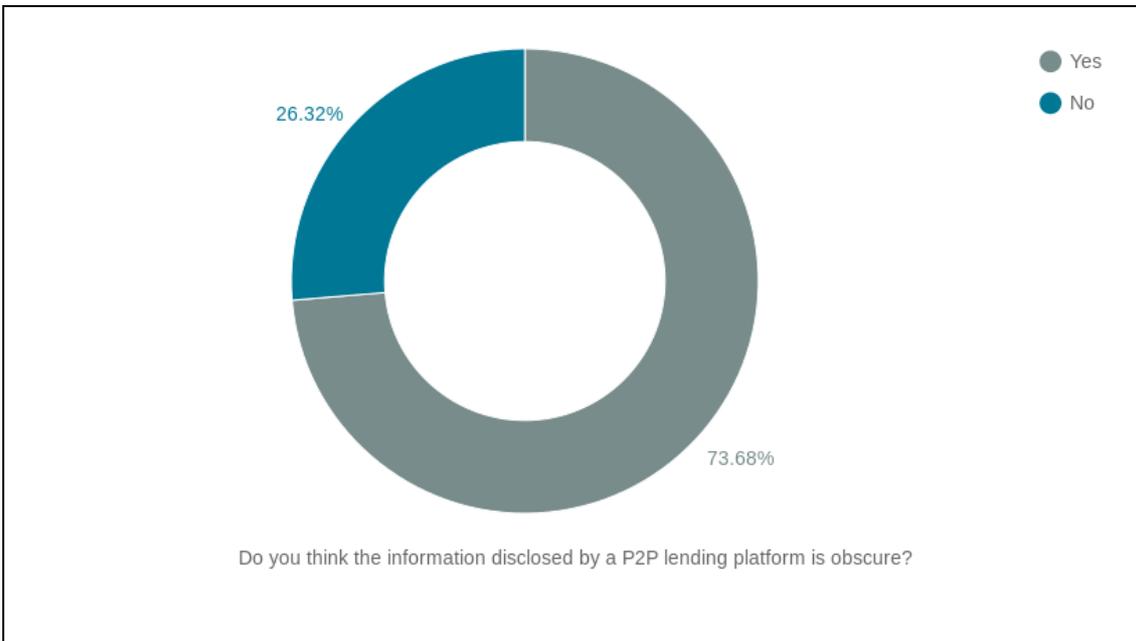


Figure 24: The Information Disclosed by a P2P Lending Platform and its Readability

Source: This figure is based on Appendix 2 (Question 17) and developed by the author.

#### 4.3.2. Summary

The eight major research results of this survey could be summarized as six categories shown in Table 27, including: (1) market familiarity: investors in China has quite familiar with CRAs of P2P lending, which has work as top three investment criteria (2) market share: though there are seven major credit rating reports of P2P lending, two major agencies have shared more than 70% of whole rating market (3) perspective of investors: investors of P2P lending has less negative attitude of CRAs of P2P lending (4) potential risks: few potential risks have been pointed out recently (5) substantial impact: around 30% investors has claimed that the credit rating report has impact on a P2P lending company both in negative and positive way (6) complementation of disclosure duty: credit rating reports of P2P lending platforms may work as complementary roles of current policy, which is disclosure duty.

Table 27: The Category of Survey Result

Category	Result of Survey
Market	More than 70% respondents have known CRAs of P2P lending
Familiarity	The credit rating report of P2P lending is top three investment criteria
Market Share	The market of CRAs of P2P lending in China is oligopoly
Perspective of Investors	The utilities of credit rating report of P2P lending in China are diversified
	Only 6.58% of P2P lending investors have strong negative attitude toward credit rating report of P2P lending in China
Potential Risks	The major risks of credit rating report of P2P lending in China: subjective criteria with insufficient scientific analysis, the risky platforms are not successfully detected, and ratings shopping
Substantial Impact	Up to 32.9% of P2P lending investors claims that credit rating report have either positive or negative impact on their P2P lending investment
Complementation of Disclosure Duty	Up to 76.32% of all respondents claim that the disclosure information of P2P lending platform without sufficient transparency, and 73.68% of all respondents indicate the information is obscure

Source: This table is constructed by the author.

#### 4.4. Judicial Perspective: Based on the Case of Duan Rong v. Rong 360

There is no specific regulation toward credit rating agency of P2P lending both in existing regulation and proposed bill as it is not within the scope of above regulations. Accordingly, this study analyzes the private litigation and its impact on credit rating agency of P2P lending. This study found that credit rating reports of P2P lending have emerged as a vital aspect of P2P lending industry in China, which may be beneficial to financial authorities, a P2P lending platform, and investors. However, as the introduction part of this chapter mentioned, DuanRong, a rated P2P lending platform, has filed a suit against Rong 360, a CRA of P2P lending in China due to DuanRong's rating of C-, which represents that a P2P lending platform is risky and investors. Therefore, the

dispute between DuanRong and Rong 360 started from December 2015. Despite the fact that Rong 360 has won the case in December 2016, DuanRong still continued their plea to high court for seeking resolution. This case is regarded as leading case of CRAs of P2P lending in China as it is the first judicial case between a rated P2P lending platform and CRAs of P2P lending.

In the following section, this study will firstly give a brief overview of legal relationship among stakeholders of credit rating industry. This Dissertation then attempts to how the relevant mechanism working in Chinese market in terms of credit rating agency and its private litigation. Finally, this section will narrow down the scope into private litigation caused by a CRA of Chinese P2P lending. Specifically, this part is mainly to answer the question whether private litigation is suitable to work as alternative resolution with effectiveness of private litigation in Chinese CRAs in P2P lending given that there is no relevant regulation yet.

#### 4.4.1. Analysis of CRAs' Stakeholders from Viewpoints of Tort and Contract Law

Analysis of legal relationship among relevant parties is an indispensable part of the study in terms of private litigation. Consequently, this study provides the overview of legal relationship under credit rating business in general. Essentially, there are three parties of stakeholders as shown in Figure 25, including a credit rating agency, a rated company, and investors, which remains the gap among them, for example, a rated company may have contract with a credit rating agency.

Nonetheless, the legal relationship between the above two parties is not always a contractual relationship as a rated company may not sign a contract with a CRA. In contrast, a CRA may

provide rating report of a rated company without its permission, known as unsolicited ratings<sup>227</sup>.

Accordingly, there is no any contract between a rated company and a CRA under above situation. In addition, though a credit rating report provides investors information of investment, there is no contractual relationship between investors and a CRA. Hence, there are several types of legal relationship among three main parties of credit rating industry as shown in Figure 25.

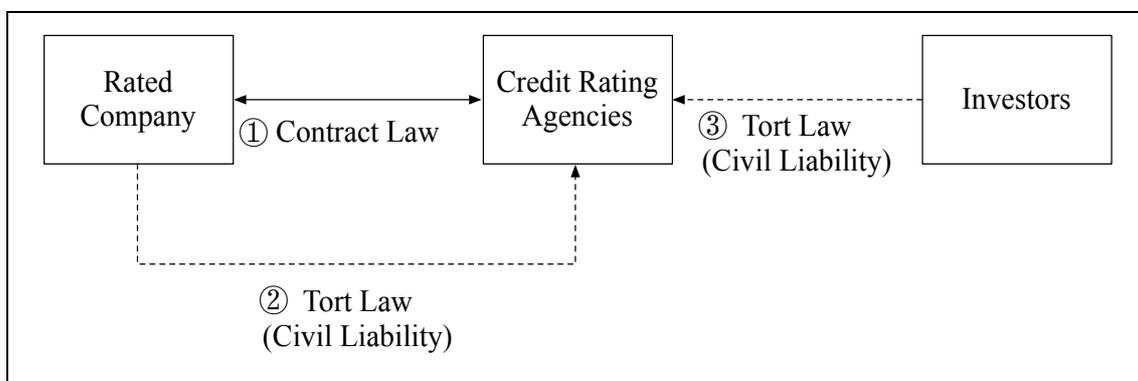


Figure 25: Legal Relationship of Tort Law and Contract Law among a Credit Rating Agency, a Rated Company, and Investors

Source: This figure is constructed by the author

#### 4.4.2. Chinese Credit Rating Agencies in tradition

Relevant regulation of private litigation in Chinese CRAs is regulated by Securities Law and provisions issued by Supreme People’s Court in China. According to Article 173 of *Securities Law of the People's Republic of China*<sup>228</sup>, “Where a securities trading service institution formulates and issues ... credit rating report ... In the case of any false record, misleading statement or major

<sup>227</sup> Naoto Shimoda and Yuko Kawai, *Credit Rating Gaps in Japan: Differences between Solicited and Unsolicited Ratings, and “Rating Splits,”* (Bank of Japan, April 2007), 4–5. “Unsolicited ratings are credit ratings that rating agencies assign without the issuers’ solicitation...”

<sup>228</sup> Securities Law of the People’s Republic of China [中华人民共和国证券法] (People’s Republic of China|CN 2014.8.31).

omission in the documents... which incurs any loss to any other person, the relevant securities trading service institution shall bear several and joint liabilities together with the relevant issuer and listed company, unless a securities trading service institution has the ability to prove its faultlessness...”. Additionally, relevant details of Article 173 have been regulated by *Some Provisions of the Supreme People's Court on Trying Cases of Civil Compensation Arising from False Statement in Securities Market*. The legal relationship regarding tort in Article 173 Securities Law of China is between CRAs and investors as shown in Figure 26.

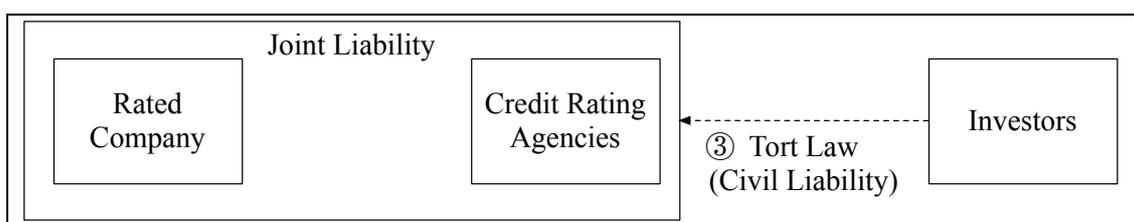


Figure 26: Legal Relationship of Article 173 Securities Law

Source: This figure is constructed by the author

As shown in Table 28, the regulatory scope is a securities trading service institution, which may not cover the business model of Chinese CRAs in P2P lending given that P2P lending is not within the definition of securities. Although the regulation does not cover credit rating of P2P lending, there are some lessons for further development of regulation, for example, according to Article 173 of Securities Law in China, a securities trading service institution need to prove its faultlessness for exemption, which reverses burden of proof under the rule of tort law. Furthermore, a securities trading service institution bears several and joint liabilities together with the relevant issuer and listed company. Nevertheless, there is still no case regarding credit rating agency versus investors.

Table 28: Constitutive Requirement Regarding Article 173 of Securities Law of the Problems People's Republic of China

Categories	Content
Regulatory Scope	a securities trading service institution
Regulated Objects	issues any auditing report, asset appraisal report, financial advising report, credit rating report or legal opinions for the issuance, listing and trading of securities
Obligation	it shall be assiduous and dutiful by carrying out examination and verification for the authenticity, accuracy and integrity of the contents of the documents applied as the base.
Behavior	In the case of any false record, misleading statement or major omission in the documents it has formulated or issued,
Damage	which incurs any loss to any other person
Liability	bear several and joint liabilities together with the relevant issuer and listed company
Exemption (burden of proof)	unless a securities trading service institution has the ability to prove its faultlessness.

Source: This table is constructed by the author

#### 4.4.3.Chinese Credit Rating Agencies in P2P Lending

On December 2016, the case regarding disputes of credit rating between Duan Rong and Rong 360 has been decided, which is deemed as the first credit rating of P2P lending case in China<sup>229</sup>.

Duan Rong, a P2P lending platform, has filed the suit against Rong 360, a CRA of P2P lending in China on December 2015. Rong 360 has published credit rating report jointly with International College, Renmin University of China from the beginning of 2015.

<sup>229</sup> Haidian District Court [北京市海淀区人民法院], “The First Case of Credit Rating Agency of P2P Lending in China: The Rating Report Provided by Rong 360 Does Not Fabricate Facts” [全国首例网贷评级不正当竞争案]宣判：融 360 发布评级报告不构成商业诋毁], District Court, 北京市海淀区人民法院, (December 27, 2016).

#### 4.4.3.1. Fact

Duan Rong was rated as C in the first report of Rong 360, which is regarded as “the ability of bearing risks is low; the brand awareness is not popular; and investors should be aware before their making decision of investment<sup>230</sup>”. In addition, Duan Rong was rated as C- and evaluated “the ability of Duan Rong is quite poor comprehensively with high risks, and investors should be highly aware<sup>231</sup>” in the second report issued by Rong 360. In contrast, Duan Rong claimed<sup>232</sup> that most of their loans are collateral-based, such as pledge loans with car or mortgage loan with real-estate. In addition, Duan Rong also set up reserve fund for working as compensation mechanism for defaults. Besides, they also hire PwC in China, top 4 accounting firms to evaluate their business, which shows that their default rate is less than 0.1%.

#### 4.4.3.2. Rules

Therefore, Duan Rong proposed that the rating provided by Rong 360 damaged their reputation and filed the suit against Rong 360 based on Article 2, Article 14, and Article 20 of Anti-Unfair Competition Law in China. Additionally, Duan Rong also claimed that Rong 360 should remove relevant reports damaging their reputation, eliminate negative effect caused by reports, and compensation of 500,000 CNY. Specifically, the core disputes focuses on Article 14<sup>233</sup> to analyze whether Rong 360 fabricated, spread false facts to damage the reputation or commodity fame of

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<sup>230</sup> DuanRong, “The Notice of DuanRong versus Rong 360, a Case Regarding Unfair Competition and Reputation.”

<sup>231</sup> Ibid.

<sup>232</sup> Ibid.

<sup>233</sup> Article 14, Anti-Unfair Competition Law of China, “Manager shall not fabricate, spread false facts to damage the business reputation or commodity fame of the other competitor.”

Duan Rong given that Article 2 is general provision and Article 20 is liability. As a result, the legal relationship between Duan Rong and Rong 360 is shown as Figure 27.

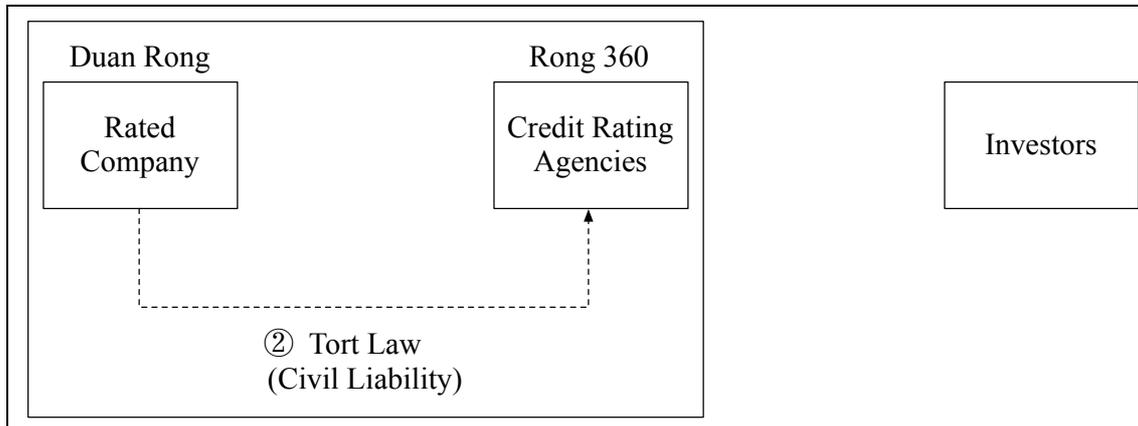


Figure 27: Legal Relationship of Duan Rong versus Rong 360

Source: This figure is constructed by the author

#### 4.4.3.3. Analysis

Three major questions have been discussed in the case of Duan Rong versus Rong 360 which includes (1) Entry Requirement: is there any entry requirement of providing credit rating report of P2P lending; (2) Conflict of Interest: could competitors provide rating report of evaluating other companies given that there may remain conflict of interest among competitors; and (3) Criteria: how to evaluate the authenticity and integrity of credit rating report of P2P lending and whether credit rating report of P2P lending is fair without bias.

According to Article 14 of Anti-Unfair Competition Law in China, the court has responded to the above disputed questions. Firstly, whether credit rating agency of P2P lending hold relevant license of issuing credit rating report is not constitutive Requirement of considering the behavior of fabrication, and spread false facts. Secondly, despite the fact that the competitor may have relatively

high possibility of fabricating, or spreading false facts, there is no absolute cause and effect between above factors. In addition, DuanRong should bare the rating result in condition of objective criteria.

Thirdly, Duan Rong failed to provide evidence supporting its argument that Rong 360 does not have rational standard of evaluating its platform.

Therefore, as Duan Rong has no strong evidence indicating that the credit rating reports issued by Rong 360 lack authenticity and integrity and also did not prove its damages caused by Rong 360, Duan Rong lost the court case. In addition, the court has further pointed out that credit rating report of P2P lending provides objective and valuable information working as investment reference for investors given that there is no relevant regulation implemented at that moment. Moreover, credit rating report of P2P lending also enhance the disclosure duty of P2P lending platforms in China. Consequently, P2P lending industry should take responsibility to be examined by credit rating agency in this industry. Relevant information is summarized as shown in Table 29.

Table 29: Summary of Duan Rong versus Rong 360

Categories	Content
Plaintiff	Duan Rong (a P2P lending platform)
Defendant	Rong 360 (a CRA of P2P lending)
Fact	DuanRong is not satisfied the rating results (C and C-) provided by Rong 360, which may damage its reputation
Rules	Article 2, Article 14, and Article 20 of Anti-Unfair Competition Law in China (fabricate, spread false facts to damage the business reputation or commodity fame of the other competitor.)
Analysis and Conclusion	DuanRong failed to prove constitutive requirements of Article 14 of Anti-Unfair Competition Law and should bare the rating result in condition of objective standard and lost the court case.

Source: This table is constructed by the author

#### 4.4.4. Summary

This research firstly analyzed legal relationship among a CRA, a rated company, and investors, which could break down into contract law and tort law liabilities because of contractual relationship. Secondly, this part also found that there is regulation of liability regarding credit rating agency but only for securities industry rather than P2P lending. Hence, private litigation of credit rating agency of P2P lending is not within the coverage regarding reversion of burden of proof, which make plaintiff not easily prove the behavior of malice and their damages. Thirdly, this Dissertation also analyzed the first case of credit rating agency of P2P lending in China and found that the court takes positive perspective toward this industry.

This is a remarkable milestone of credit rating agency of P2P lending as there is no regulation of supporting this industry before. The attitude of district court could work as fundamental base of further development. Although it might be too early to conclude whether the attitude of the court have positive impact or not, the mechanism of credit rating agency of P2P lending in China has been recognized officially to some extent, which may enhance the mechanism of credit rating industry regarding Chinese P2P lending.

#### 4.5. Regulatory Perspective: Relevant Regulation of Credit Rating Agencies in China

According to the survey conducted in previous chapter, it indicated that CRAs of P2P lending have influential impact on market since around 70% respondents knew this industry and more than 90% of this group took positive attitude of rating reports published by them, which shows the impact of this industry. However, there are also up to 76.32% of all respondents claim that the disclosure information of P2P lending platform without sufficient transparency. 73.68% of all respondents

indicate the information is obscure, which may possibly mislead investors in the market according to historical experiences of CRAs, such as financial crisis in 2008.

Though most respondents have no strong negative impression of this industry, the issues such as subjective criteria with insufficient scientific analysis, the risky platforms are not successfully detected, and ratings shopping, are also highly concerned by participants of the survey conducted by this dissertation, which is still not under the regulatory scope by Chinese financial authorities yet. In other words, this study found that the spotlight of regulation in Chinese P2P lending industry is still mainly on P2P lending platforms rather than comprehensive overview of industry ecosystem. Specifically, there is no relevant regulation of credit-rating agencies in Chinese P2P lending industry as it is not covered by the definition of existing legal framework. In other words, there is no specific law to deal with problems occurred due to mistakes provided by credit-rating agencies in P2P lending industry of China.

#### 4.5.1.Literature Review

CRAs has emerged as a highly debated issue again since the global financial crisis in 2008. The question of whether to strengthen regulation of CRAs is widely discussed and concerned by financial authorities across the world. The most significant core issue of CRA is reducing asymmetry information as ranking of rating reports could be distorted due to corruption or manipulation of securities market. However, the essence of CRAs business model in most practices has increased difficulty to justify the intervene of rating distortion in some cases as the business model of CRAs is mostly based on issuer-paid model, which has been implemented for a couple decades since 1970s as introduced in previous chapter. Hence, there are many previous literature exploring existed flaws

of CRAs for improving its transparency and protecting the right of investors in capital market, which could roughly divided into two eras.

#### 4.5.1.1. Before 2008

Schwarcz takes the view that the regulation would not increase efficiency in terms of CRAs as the industry of CRAs providing accurate ratings because their profitability highly relates to reputation<sup>234</sup>. Moreover, he also indicated that the regulation may lead to political manipulation<sup>235</sup>. Additionally, Hill also holds the positive opinion of CRAs and further did comparative study between CRAs and accounting firms that CRAs are able to take the pressure of their clients comparing with accounting firms as the profits of rating agencies are mainly the rating services rather than any other ancillary services but accounting firms in vice versa<sup>236</sup>, which may guarantee the independence of CRAs to some extent. Both Schwarcz and Hill took the view that CRAs have independence of their profession based on their unique business model, which may not need too much regulatory intervention from government sectors.

#### 4.5.1.2. After 2008

In contrast, other academic schools take the opinion that the reputation mechanism underlying and advocating by scholars is prone to fail. Lynch objects to the optimistic viewpoint of reputational standing approach of CRAs and indicates that self-interest of CRAs may hinder above approach as

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<sup>234</sup> Steven L. Schwarcz, "Private Ordering of Public Markets: The Rating Agency Paradox," *U. Ill. L. Rev.* 2002 (2002): 1–3.

<sup>235</sup> *Ibid.*

<sup>236</sup> Claire A. Hill, "Regulating the Rating Agencies," *Wash. ULQ* 82 (2004): 74–75.

rating information provided by CRAs in private-sector is profit-seeking rather than integrity<sup>237</sup>. Additionally, the establishment of public-sector CRAs may be needed for improving existing regulatory environment<sup>238</sup>. Moreover, Hunt argued that CRAs, providing low quality of credit ratings, should take liability by antifraud rules<sup>239</sup>. Nagy hold the viewpoint that rating report issued by CRAs should not be shield by First Amendment in the United States, which have to take liability<sup>240</sup>. Although above academic schools share the common argument that the regulatory framework of CRAs should not rely on reputational mechanism merely anymore, their proposed solution remains difference.

Notwithstanding the fact that schools remain divergence of CRAs and its regulatory framework, the literature<sup>241</sup> has categorized under the common regulation method proposed by Shleifer<sup>242</sup> as shown in Table 30, for example, as shown in

Table 31, reputational mechanism proposed by Schwarcz and Hill is under the concept of market discipline. The liability of CRAs advocated by Nagy could be categorized as private litigation. The responsibility of low quality ratings suggested by Hunt is likely the public enforcement through regulation. And establishment of public sector credit-rating agencies contended by Lynch is the category of state ownership. To sum up, based on literature review, the regulatory

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<sup>237</sup> Timothy E. Lynch, “Deeply Persistently Conflicted: Credit Rating Agencies in the Current Regulatory Environment,” *Case W. Res. L. Rev.* 59 (2008): 227.

<sup>238</sup> *Ibid.* at 291–300.

<sup>239</sup> John Patrick Hunt, “Credit Rating Agencies and the Worldwide Credit Crisis: The Limits of Reputation, the Insufficiency of Reform, and a Proposal for Improvement,” *Colum. Bus. L. Rev.* 2009 (2009): 53–54.

<sup>240</sup> Theresa Nagy, “Credit Rating Agencies and the First Amendment: Applying Constitutional Journalistic Protections to Subprime Mortgage Litigation,” *Minn. L. Rev.* 94 (2009): 143–45.

<sup>241</sup> Fang Tianzhi (方添智), *A Research of the Regulation on Conflicts of Interest Relating to Credit Ratings: The Study and Reference Focusing on America* [信用评级利益冲突规制研究-以美国为中心的研究与借鉴] (Beijing: China Commerce Trade Press, 2012), 33–35.

<sup>242</sup> Andrei Shleifer, “Understanding Regulation,” *European Financial Management* 11 (2005): 442–43.

approach of credit-rating agencies could be roughly divided into four main characteristics from market-driven to government-driven regulatory mechanism, which could provide a lesson for analyzing and proposing legal framework of credit-rating agencies of P2P lending in China.

Table 30: Four Main Regulatory Approaches

	Market Discipline <sup>243</sup>	Private Litigation	Public Enforcement through Regulation <sup>244</sup>	State Ownership <sup>245</sup>
Fundamental Base	Reputation Mechanism	Self-Interest	Enforcement Power	
Problems	Reputation is not always reliable	Huge gap between two parties	Monopoly	Efficiency, Corruption

Source: This table is constructed by the author

<sup>243</sup> Shleifer, “Understanding Regulation.” “...take the example of social control of securities issues...it can rely on the reputational incentives of the issuers themselves, or of their underwriters, to disclose the truth about the securities...”

<sup>244</sup> Ibid. “...the society can create a regulatory agency which mandates what should be disclosed by security issuers, inspects these disclosures, and penalises issuers and underwriters who fail to conform to the regulations...”

<sup>245</sup> Ibid. “...the government can nationalise all security issuance, so its own agents make representations and sell stocks...”

Table 31: Comparative Scholarship of Credit Rating Agencies Regulation

Regulatory Theories	Advocators	Reasons
Market Discipline (market-driven)	Schwarzc, Hill	<ol style="list-style-type: none"> <li>1. Profitability of CRAs is highly relating to reputation</li> <li>2. The profits of rating agencies are mainly the rating services rather than any other ancillary services</li> <li>3. CRAs have independence based on their unique business model</li> </ol>
Private Litigation	Nagy	CRAs should not be shield by First Amendment in the United States anymore
Public Enforcement through Regulation	Hunt	<ol style="list-style-type: none"> <li>1. Credit ratings with low quality should take liability by antifraud rules</li> <li>2. New rating product should have permission allowed by SEC</li> </ol>
State Ownership (government-driven)	Lynch	<ol style="list-style-type: none"> <li>1. CRAs in private-sector is profit-seeking rather than integrity</li> <li>2. The establishment of public-sector CRAs may be needed</li> </ol>

Source: This table is constructed by the author

Although there are plenty academic discussions of credit-rating agencies and its failure of highly relying on reputational mechanism after financial crisis in 2008, most academic discussion of CRAs are focusing on issuer-paid model, investor-paid model and their flaws rather than hybrid model or innovative model<sup>246</sup>, such as CRAs of P2P lending in China. Namely, previous studies tended to focus on popular business model of CRAs in traditional capital market. There are insufficient studies on the business model of CRAs in Chinese P2P lending industry, which is hard

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<sup>246</sup> See Table 25 on page 94 of this dissertation

to be categorized as issuer-paid or investor-paid model as the rated object is a P2P lending platform rather than borrowers or investors as shown in Figure 28 and Figure 29. In other words, the previous theories of credit-rating agencies may not directly be implemented as the business model and relationship among CRAs and rated object is different.

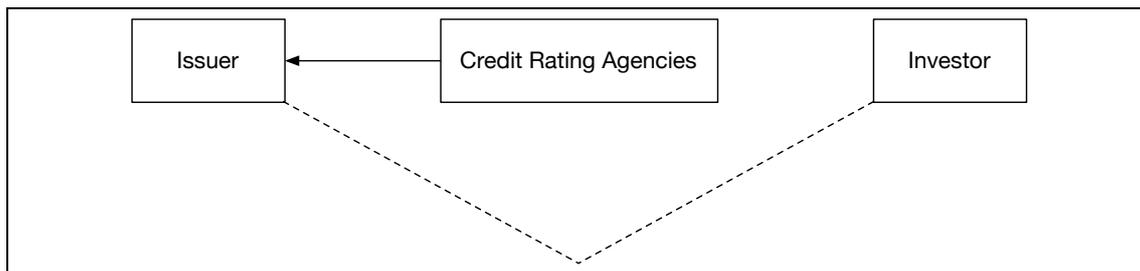


Figure 28: Typical Rated Object of Credit Rating Agencies

Source: This figure is constructed by the author

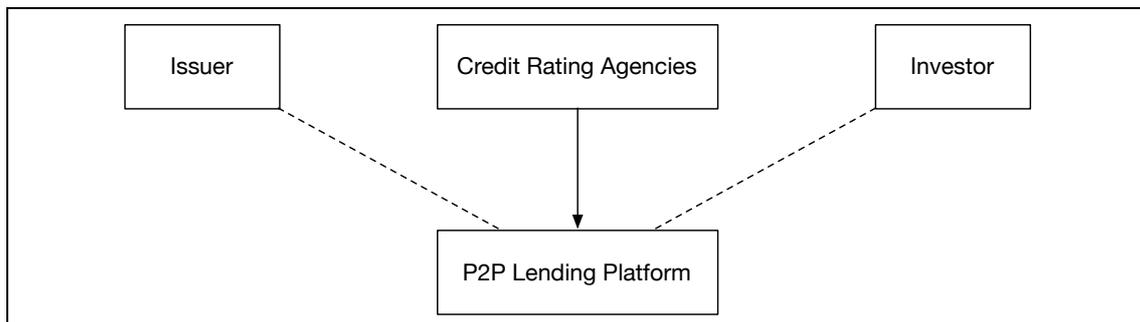


Figure 29: Rated Object of Credit Rating Agencies in Chinese P2P Lending

Source: This figure is constructed by the author

Specifically, the rated object is an intermediary agency of loan, a P2P lending platform, rather than issuer in tradition as shown in Figure 28. Under the scope of definition provided by relevant regulation of credit-rating agencies, the business provided by CRAs in Chinese P2P lending may not be within the scope. Specifically, it is not regulated yet at the moment. In order to establish a legal framework of CRAs of Chinese P2P lending, it is necessary to have an overview of current credit

rating regulation in China for understanding whether it is possible to implement in P2P lending's rating or are there any characteristics that should be taken into consideration for further proposed legal framework.

With above discussion, this study found that theories of CRAs remain gaps among academic scholars, which is from market-driven to government-driven regulatory framework. Therefore, it is important to understand which type of regulatory framework may be suitable for CRAs of P2P lending in China. Given that market discipline may not be suitable in China at this moment as Chapter 3 discussed and state ownership is also not well-practiced yet, this study will focus on public enforcement through regulation, especially there are relevant existing regulations in China. In the following few sections, this research will have analysis as following sequences, (1) the relevant regulation of CRAs in China and (2) recent proposed bill.

#### 4.5.2. The Relevant Regulation of Credit Rating Agencies in China

In the previous section, this study found that the existing academic discussion of CRAs may not cover the credit rating industry of P2P lending in China given that the business model may not be similar. Based on this basic understanding, this Dissertation will further discuss the relevant legal framework of CRAs in China, including regulatory authorities, relevant existing regulation, and recent proposed bill. The research will analyze: (1) differences between legal framework between China and other leading countries (2) whether CRAs of P2P lending is regulated by financial authorities in China or not (3) if it is not covered by relevant regulation in China, should it be included or excluded due to divergence of their business models. Through above analysis, it is helpful to clarify the legal status of the industry of CRAs in Chinese P2P lending.

#### 4.5.2.1. Regulatory Authorities: Multi-Authorities by Rating Objects

The industry of CRAs has been regulated by several authorities in China as shown in Table 32, mainly (1) National Development and Reform Commission (NDRC): an agency of macroeconomic management with broad administrative power over the Chinese economy (2) The People's Bank of China (PBC): the central bank in China (3) China Securities Regulatory Commission (CSRC): Chinese securities authority. NDRC has announced that business debt and guarantee institution should go through the process of credit rating. Furthermore, PBC has provided requirement of credit rating, such as credit rating market and debt among banks. In addition, credit rating of Chinese securities market is necessary to have credit rating process based on guideline provided by CSRC.

Table 32: Relevant Authorities and Regulation of Chinese Credit Rating Agencies

Authorities	Relevant Regulation	Regulated Objects
National Development and Reform Commission (NDRC)	Notice of Enhancing Improvement of Enterprise Bond Market <sup>247</sup>	Bond Market
The People's Bank of China (PBC)	Guiding Opinions of the People's Bank of China for the Management of Credit Rating <sup>248</sup>	Inter-bank Bond Market and the Credit Market
China Securities Regulatory Commission (CSRC)	-Standards of Bond Credit Rating Report of Securities Agency Provided by Credit Rating Agency <sup>249</sup> - Interim Measures for the Administration of the Credit Rating Business Regarding the Securities Market <sup>250</sup>	Securities Market, and Bond Market

Source: This table is constructed by the author

This study found that regulatory authorities of CRAs have multi authorities based on rating objects issued by CRAs. Consequently, there is no centralized institution to regulate the industry of CRAs overall in China. At first glance, the system of multi-authorities regarding regulation of credit-rating agencies may be efficient as each authority has its own diversified profession, which may be correspondent with different types of CRAs. Nonetheless, Zhao<sup>251</sup> has criticized that the direction

<sup>247</sup> Notice of Enhancing Improvement of Enterprise Bond Market [国家发展改革委办公厅关于进一步改进企业债券发行工作的通知] (People's Republic of China|CN 2013.8.2).

<sup>248</sup> Guiding Opinions of the People's Bank of China for the Management of Credit Rating [中国人民银行信用评级管理指导意见] (People's Republic of China|CN 2006.4.4).

<sup>249</sup> Standards of Bond Credit Rating Report of Securities Agency Provided by Credit Rating Agency [资信评级机构出具证券公司债券信用评级报告准则] (People's Republic of China|CN 2003.8.29).

<sup>250</sup> Interim Measures for the Administration of the Credit Rating Business Regarding the Securities Market [证券市场资信评级业务管理暂行办法] (People's Republic of China|CN 2007.9.1).

<sup>251</sup> Zhao Yuanyuan (赵园园), "The Legal Framework of Credit Rating Agency in China and Its Improvement – Based on Financial Security" [我国信用评级法律制度的完善——以金融安全为视角], *Theoretical Exploration* [理论探索], March 2011, 142–43.

among NDRC, PBC, and CSRC remains difference to some extent, limiting the development of Chinese CRAs. Moreover, Zhao<sup>252</sup> also indicated that CRAs should be only regulated by PBC as most credit rating business is relevant with bank because banks work as major fundraising channel in Chinese market.

Though there are still some disputes of multi financial authorities on Chinese CRAs, the existing regulatory model is multi-authorities at this stage. As a result, it is critical to evaluate which authorities would be suitable for Chinese CRAs of P2P lending. Nevertheless, there is no strong or direct connection among P2P lending and existing financial authorities of CRAs, such as NDRC, PBC, and CSRC. Based on the criteria of regulatory framework of current CRAs in China, such as CRAs of securities market is responsible for CSRC, the suitable authority of Chinese CRAs of P2P lending may be CBRC, the main authority of P2P lending is China Banking Regulatory Commission (CBRC).

#### 4.5.2.2. Relevant Regulation: Multi and Specific

In previous section, this study has found that the financial authorities of CRAs are separately responsible by NDRC, PBC, and CSRC as shown in Table 33. In order to have comprehensive overview of regulatory framework regarding CRAs, it is necessary to understand relevant regulation. Although there are four major regulations of CRAs in China, around 49 relevant regulations have also directly or indirectly regulate this industry, which shows that there is no single regulation on CRAs. Hence, this study found that there is no specific regulation of CRAs in China at this stage.

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<sup>252</sup> Ibid.

Instead, existing regulation of credit rating agency is only part of certain law or guideline. Even though there are some regulation specific to CRAs, it does not cover comprehensive business models of credit rating activities.

Table 33: Major Regulations of Credit Rating Agencies in China

Date	Authorities	Title	Scope
2003.8	CSRC	Standards of Bond Credit Rating Report of Securities Agency Provided by Credit Rating Agency <sup>253</sup>	Bond Market
2006.3	PBC	Guiding Opinions of the People's Bank of China for the Management of Credit Rating <sup>254</sup>	Inter-bank Bond Market and the Credit Market
2007.8	CSRC	Interim Measures for the Administration of the Credit Rating Business Regarding the Securities Market <sup>255</sup>	Securities Market
2008.3	PBC	Notice of the People's Bank of China on Strengthening the Management of the Credit Rating Practices in Inter-bank Bond Market <sup>256</sup>	Inter-bank Bond Market

Source: This table is constructed by the author

*Interim Measures for the Administration of the Credit Rating Business Regarding the Securities Market*” is regarded as comprehensive regulation of CRAs, which is issued by CSRC.

However, the scope of above regulation only covers securities market. And “*Notice of the People's*

<sup>253</sup> Standards of Bond Credit Rating Report of Securities Agency Provided by Credit Rating Agency.

<sup>254</sup> Guiding Opinions of the People’s Bank of China for the Management of Credit Rating (People’s Republic of China|CN 2006.4.4).

<sup>255</sup> Interim Measures for the Administration of the Credit Rating Business Regarding the Securities Market.

<sup>256</sup> Notice of the People’s Bank of China on Strengthening the Management of the Credit Rating Practices in Inter-bank Bond Market [中国人民银行关于加强银行间债券市场信用评级作业管理的通知] (People’s Republic of China|CN 2008.3.11).

*Bank of China on Strengthening the Management of the Credit Rating Practices in Inter-bank Bond Market*” is only for credit rating services regarding inter-bank bond market. There also remains the legislative level in difference between previous two regulations, which is “Measure” and “Notice” separately. Two characteristics of Chinese CRAs are found, including no single regulation and different legislative level.

Under current regulatory framework of Chinese CRAs, it is hard to have implementation of previous mentioned regulation on CRAs of P2P lending as each regulation at this stage is quite specific for certain credit rating service. In other words, CRAs of P2P lending is out of scope of existing regulatory scope of CRAs. Accordingly, relevant regulation should be developed for providing entry requirements of CRAs of P2P lending in China under this situation.

#### 4.5.3. Proposed Bill of Regulating Credit Rating Agencies in China

In order to regulate activities of credit rating, protecting the right of stakeholders, and enhance the development of credit rating industry, PBC has jointly drafted and published consultation paper with NDRC and CSRC on October 2016, which is known as *Interim Measures for the Administration of Credit Rating: Consultation Paper*<sup>257</sup>. There are nine chapters of this proposed bill regarding credit rating regulation, including (1) General, (2) Management of Credit Rating Agency, (3) Management of Staff in Credit Rating Agency, (4) Procedures and Rules of Credit Rating, (5) Independence Requirement, (6) Disclosure Duty, (7) Supervision, (8) Liability, and (9) Others. Following paragraphs, this research will firstly overview the regulatory authorities and regulatory

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<sup>257</sup> Interim Measures for the Administration of Credit Rating (Consultation Paper) [信用评级业管理暂行办法（征求意见稿）] (People’s Republic of China|CN 2016.10.12).

scope of this proposed bill for understanding its target. This study looks into relevant measure of pursuing neutrality of CRAs, including “Independence”, “Rule of avoidance”, and “Liability”.

#### 4.5.3.1. Regulatory Authorities and Regulatory Scope

Under Article 3 of *Interim Measures for the Administration of Credit Rating: Consultation Paper*, there are two categories of regulatory authorities, which includes industry authority and market authorities of credit rating activities. PBC is an industry authority and PBC, NDRC, and CSRC are authorities. Based on regulation provided by Article 4 and 5, industry authority is mainly responsible for developing policy and market authorities are administrative agencies of this proposed regulation. According to section 2<sup>258</sup>, credit rating is an activity that credit rating agency analyzes credit risk factors of economic subject or debt fundraising tool, synthetical evaluation of debt paying ability and repaying willingness, and provide credit rating result by defined symbol as summarized in Table 34. Therefore, the rated object is “*economic subject*” or “*debt fundraising tool*”. The rated target is “*debt paying ability*” and “*repaying willingness*” of above rated object. And rating result is shown as “*defined symbol*”.

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<sup>258</sup> Credit rating is an activity that credit rating agency analyzes credit risk factors of economic subject or debt fundraising tool, synthetical evaluation of debt paying ability and repaying willingness, and provide credit rating result by defined symbol. (本办法所称信用评级，是指信用评级机构对影响经济主体或者债务融资工具的信用风险因素进行分析，就其偿债能力和偿债意愿做出综合评价，并通过预先定义的信用等级符号进行表示。)

Table 34: Regulatory Scope of Interim Measures for the Administration of Credit Rating

Items	Content
Rated Object	“economic subject” or “debt fundraising tool”
Rated Target	“debt paying ability” and “repaying willingness”
Rating Result	rating result is shown as “defined symbol”

Source: This table is constructed by the author

#### 4.5.3.2. Independence from a Rated Company

Regarding independence requirement of this proposed bill, there are four perspectives as shown in Table 35, which are from Article 33 to 34 and Article 36 to 37, including: (1) independence of rating business: the rating results should be prevented from influences by other business activities<sup>259</sup> (2) independence of a CRA: if a CRA hold shares of a rated companies of is hold by a rated company directly or indirectly more than 5%, the credit rating agency is forbidden to provide a rating service to the rated company<sup>260</sup> (3) independence among organizations: rating department should be independent from other departments of a CRA for ensuring its objectiveness<sup>261</sup> (4) salary independence: salary of a staff engaging credit rating should not have any connection with rating result or business condition of a rated company<sup>262</sup>.

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<sup>259</sup> Article 33, Interim Measures for the Administration of Credit Rating

<sup>260</sup> Article 34, Interim Measures for the Administration of Credit Rating

<sup>261</sup> Article 36, Interim Measures for the Administration of Credit Rating

<sup>262</sup> Article 37, Interim Measures for the Administration of Credit Rating

Table 35: Requirements of Independence Provided by Interim Measures for the Administration of Credit Rating

Type of Independence	Regulation	Content
Independence of rating business	Article 33	Improper influence by business activities should be prevented
Independence of a credit rating agency	Article 34	Avoid conflict of interest caused by share ownership
Independence among organizations	Article 36	Firewall of credit rating department
Salary independence	Article 37	Salary of credit rating staff is not connecting to a rated company

Source: This table is constructed by the author

#### 4.5.3.3. Rule of avoidance

In previous section, most requirements are much more relating to the structure of a CRA, which ensures the credit rating services could operate without improper influence due to conflict of interest from institutional perspective. In this section, the object is limited to a staff of the credit rating department. Regarding rule of avoidance, it is regulated by Article 35 of the proposed bill with 5 perspectives, which a staff of the credit rating department and his/her immediate relatives should not have the following conditions, including: (1) hold more than 5% share ownership or de facto controls of the rated company (2) work as director, supervisor, or important position of the rated company (3) work as accountants, lawyers, or consultants of the rated company (4) the transaction with the rated company is more than 500,000 CNY and (5) other activities may have negative impact of independence.

#### 4.5.3.4. Disclosure of Rating Criteria

The requirements of disclosure duty are from Article 38 to Article 44 of this proposed bill, there are four perspectives should be highlighted, including: (1) basic information: shareholder structure, rating method, rating symbol, and so on<sup>263</sup> (2) independence: providing consulting service to a rated company<sup>264</sup> (3) rating quality: the default rate of credit rating<sup>265</sup> (4) rating source: the basis of credit rating<sup>266</sup>.

#### 4.5.3.5. Liability of Rating Result

As shown in Table 36, regarding liability of credit rating industry, it is mainly regulated in Chapter 8 of this proposed bill, which is from Article 53 to Article 62, including three major categories: (1) behavior of a CRA: without registration, mendacious, without legal procedures, decline the inspection, moral issues (2) behavior of a staff of credit rating department: without registration, conflict of interest (3) black list: break faith, illegal behavior.

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<sup>263</sup> Article 39, Interim Measures for the Administration of Credit Rating

<sup>264</sup> Article 40, Interim Measures for the Administration of Credit Rating

<sup>265</sup> Article 41, Interim Measures for the Administration of Credit Rating

<sup>266</sup> Article 42, Interim Measures for the Administration of Credit Rating

Table 36: Liability of Credit Rating Industry

Type	Cause	Regulation	Punishment
Behavior of a Credit Rating Agency	Without registration	Article 54	50% revenue (100%-300%)
	Mendacious	Article 56	50% revenue (100%-300%)
	Without Legal Procedures, Independence, and Disclosure Duty	Article 57	50% revenue (100%-300%)
	Decline the Inspection	Article 58	10,000 CNY per day
	Moral Issues	Article 60	1. 100%-300% revenue 2. Subjective element is “intention” or “gross negligence”
Behavior of a Staff of Credit Rating Department	Without registration	Article 55	100%-300% salary
	Conflict of interest	Article 59	1. 50% bribery (100%-300%) 2. Criminal liability
Black List	Break Faith	Article 61	Disclose on black list
	Illegal Behavior	Article 62	Disclose on CreditChina

Source: This table is constructed by the author

The subjective element of Article 60 (liability of breaking professional ethics) is “intention” or “gross negligence”, which prevents abuse of litigation against CRAs. According to Article 60, if investors, client, or rated companies have damages due to intention or gross negligence caused by a CRA, a CRA should be fined. It is not difficult to imagine that the burden of proof of “intention” or “gross negligence” would be tough for plaintiff. Besides, the punishment of this proposed bill is mostly based on revenue of a CRA during illegal period, for example, according to Article 54, a CRA without registration should be fined the amount of its 50% revenue. If a CRA

does not make improvement, the fine will increase from 100% to 300% of its revenue and ask to leave the credit rating industry.

In addition to above measures, the mechanism of black list should also be highlighted.

According to Article 61 and 62, a CRA and a staff of credit rating department may be posted on black list if they break the regulation. As a result, the punishment not only relies on fine or criminal penalty but also market mechanism. Given that the credit rating industry is mostly based on their reputation for expanding their market scale, a CRA should not receive bribes or have conflict of interest for maintaining their further rating business. Compared with liability provided in other regulation, such as *Interim Measures for the Administration of the Credit Rating Business Regarding the Securities Market*<sup>267</sup>, the liability of proposed bill could directly have negative effect on rating business of a CRA rather than simply based on fine or criminal liability.

#### 4.5.4. Summary

Although the proposed bill is still a consultation paper, there are some important characteristics, as shown in Table 37. First, according to Article 2, though there are three relevant authorities (PBC, NDRC, and CSRC), the main authority is only PBC rather than multi-authorities in current stage. Second, the regulatory scope is broader than existing regulation, which provide comprehensive coverage of credit rating industry instead of separate regulation with different standards. Third, requirements of independence and rule of avoidance are more in details compared

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<sup>267</sup> “Where a securities rating agency commits any of the following acts, it shall be ordered to make correction, be warned, and be fined with 10,000 yuan up to 30,000 yuan; and the directly responsible person in charge and other directly liable persons shall be fined with 100,000 yuan up to 300,000 yuan...” Article 41, *Interim Measures for the Administration of Credit Rating*

with relevant regulation at the moment. Finally, the liability is mostly connected to reputation mechanism rather than fine and criminal liability, which may not have a remarkable effect as the profit of illegal behavior may have more benefits than a fine. In addition, the mechanism of black list is also another example of deterrence through reputation mechanism.

Table 37: Existing Regulations and the Proposed Bill of Chinese Credit Rating Industry

	Existing Regulations <sup>268</sup>	Proposed Bill
Regulatory Scope	Narrow (Securities Market)	Broad
Main Regulatory Authorities	PBC, NDRC, CSRC, and others	PBC (executed by PBC, NDRC, and CSRC)
Disclosure and Independence	Simple	Detail
Liability	Fine and Criminal liability	1. Fine and Criminal liability 2. Fine is based on illegal revenue from 50%-300%
Black list	No	Yes

Source: This table is constructed by the author

Though the proposed bill of Chinese credit rating industry is a great improvement compared with existing regulations, both existing regulations and proposed bill not covered the business model of credit rating agency of Chinese P2P lending as shown in Figure 30. The regulatory scope of existing regulations is only within coverage of bond market, inter-bank market, securities market, and so on. In addition, the rated target of proposed bill is “debt paying ability” and “repaying

<sup>268</sup> Standards of Bond Credit Rating Report of Securities Agency Provided by Credit Rating Agency, Guiding Opinions of the People's Bank of China for the Management of Credit Rating, Interim Measures for the Administration of the Credit Rating Business Regarding the Securities Market, and Notice of the People's Bank of China on Strengthening the Management of the Credit Rating Practices in Inter-bank Bond Market

willingness”, which does not cover credit rating agencies of Chinese P2P lending given that rated target is the performance of a P2P lending platform rather than any borrower. Consequently, neither existing regulations nor the proposed bill of Chinese credit rating industry could be implemented as the business model is not covered yet.

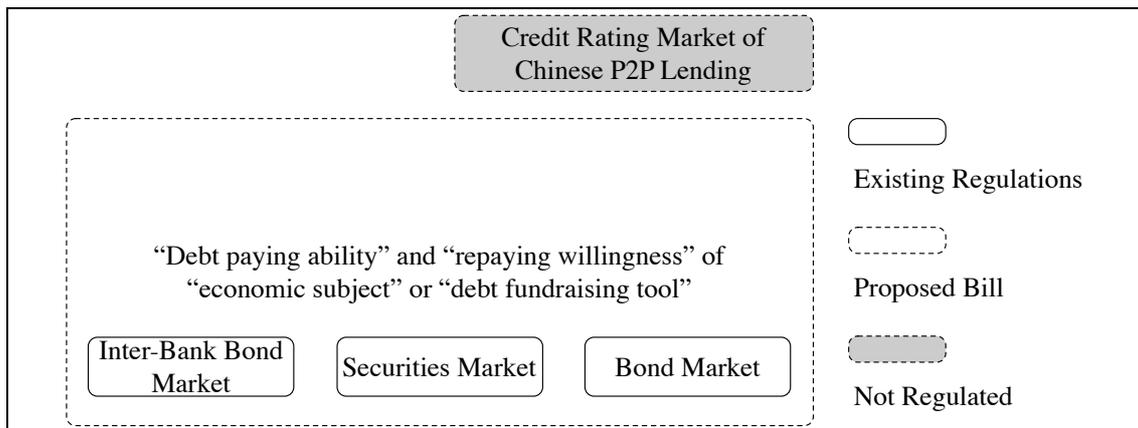


Figure 30: Regulatory Scope of Chinese Credit Rating Industry

Source: This figure is constructed by the author

#### 4.6. Analysis and Reflection

This study found that seven major rating reports could be further categorized as following, including (1) person, (2) academic institution, (3) traditional credit rating agency, and (4) CRAs of P2P lending. From the frequency of rating reports of P2P lending, this study found the necessity of CRAs having its impact on investors and the industry. However, there remains gap among different CRAs, which should be prevented for reducing possible agent costs.

With the understanding the CRAs in China and its development on P2P lending industry, this Dissertation conducted a survey with the scope of P2P lending investors. This study has summarized six research findings of this survey, including market familiarity, market share, perspective of

investors, potential risks, substantial impact, and complementation of disclosure duty, which could be foundation for further discussion on legislation, for example, this research found that 70% of general public are familiar with CRAs of P2P lending, which could be evidence of CRAs have impact on P2P lending industry. Due to market share of this industry is relatively oligopoly, it is important to know how to enhance competition for increasing transparency. From the perspective of investors, this study found that most investors of P2P lending have high trust on credit rating report of P2P lending, which should be dangerous as there is no regulation to prevent fake credit rating. This Dissertation also found that there remain potentials risks of this industry, which need to be examined by relevant authorities. The substantial impact should also be aware as there are 32.9% of respondents claim that there are either positive or negative impact on the rated P2P lending platforms by credit rating reports.

The case of Duan Rong versus Rong 360 shows the dispute between a CRA and a rated company, which is regarded as the first case in China after several years of the development of P2P lending. There are several reflections, including: (1) there is no formal system for a rated company for filing a complaint through CRAs of P2P lending (2) the rating report of P2P lending is supported by the court (3) a P2P lending platform has obligation to bare evaluation by CRAs. Though the opinions provided by the court could enhance the function of CRAs of P2P lending, CRAs of P2P lending in China should also be included in the current regulatory framework of CRAs.

Therefore, this dissertation found that CRAs of P2P lending in China has positive impact on Chinese P2P lending industry as it provides investors an alternative channel for understanding disparities among 3,000 platforms in the market in an efficient way, which reduce transaction cost of information. However, CRAs may also increase transaction cost of information, reducing

transparency of the market, for example, CRAs were deemed as one of crucial factors of financial crisis in 2008 as the mechanism of credit rating did not detect problematic companies successfully, which may be connected to conflict of interest and not disclose. Hence, CRAs may lead investors the wrong way, which should be regulated to improve objectiveness of information. In spite of above issues is highly debated and discussed, this study found that both existing and proposed regulation do not cover the business model of CRAs of P2P lending. Given that proposed regulation is on process with well-designed regulation, such as liability, disclosure, and independence, CRAs in Chinese P2P lending should be within the regulatory scope for enhancing its objectiveness for gaining trust from public and providing reliable rating for regulating P2P lending industry.

## Chapter 5 Conclusion

Despite the fact that hard-law is an essential tool as a common approach in most regulatory practice, it could not show remarkable effect on P2P lending in Chinese market, especially there are several hundred platforms going into bankruptcy in recent years as well as notorious frauds of P2P lending, such as Ezubao and Esudai. In other words, it is necessary to establish a mechanism for enhancing market transparency for further development of P2P lending in China. This study focuses on soft-law mechanism as an alternative choice under current hard-law framework.

Prevailing soft-law theories discussed in Chapter 2 aid the understanding of soft-law's role and function in various disciplines as well as online innovative finance industry, such as P2P lending industry. However, there has not been a theory that provides a complete picture of soft-law's role in the P2P lending industry. Given the diversity of various discussed context of soft-law, a theory about one type of soft-law does not transplant easily to other types. Therefore, these theories may be regarded, to a large extent, as complementary rather than mutually exclusive.

With above understanding, this study has identified regulatory approaches of soft-law mechanism in P2P lending as association-based in the UK and credit rating agency-based in China. The discussion of associated-based mechanism of soft-law are discussed in Chapter 3. And the analysis of credit-rating agencies in Chinese market has been addressed in Chapter 4. This dissertation sums up key findings as following three sections, including (1) the gap of P2P lending association between the UK and China, (2) the route of soft-law in Chinese P2P lending: CRAs, and (3) CRAs of Chinese P2P lending should be regulated for pursuing objectiveness.

### 5.1. The Gap of P2P Lending Association between The UK and China: Independence

In Chapter 3, from socio-legal and comparative law viewpoints, the history of self-regulation practice in the UK financial industry was developed for a long history. In other words, the phenomenon of self-regulation is not only in P2P lending industry but also other financial industries. The successful factors of organizing Peer-to-Peer Lending Financial Association (P2PFA) as discussed in Chapter 3 includes, (1) customs and successful practices of self-regulation in financial industry, (2) the number of platforms are still small, (3) the efficient dialogue between financial authorities and association. Though there are some literature suggests that association-based self-regulation should be introduced into China, this dissertation finds there are some difficulties to realize the goal at this moment. The concept of association-based self-regulation system is independence from government sectors embedded in financial regulation framework in the UK, and cannot be easily transplanted to the Chinese context.

There are some findings that explain why association-based self-regulation is not efficient in China. The development of association-based regulation is still at the initial stage and the autonomy of association is relatively not strong in China. Namely, the phenomenon of strong leading power by government still remains. Without autonomy of association members, the process of decision making is more like top-down than bottom-up model.

The characteristics of existing association-based self-regulation in China includes (1) few platforms are covered, (2) weak inner integration caused by lack of cohesion, (3) the monopoly phenomenon occurred by high entry threshold. Accordingly, the independence of industry association may not be ensured. Although associate-based self-regulation is still beneficial to P2P

lending industry, this study finds that its function of addressing asymmetry information is relatively weak, comparing with the model in the UK due to its history, industry practice, and market structure.

## 5.2. The Route of Soft-Law in Chinese P2P Lending: Credit Rating Agencies

Chapter 4 of this dissertation finds that CRAs of P2P lending in China are critical roles for improving problems of asymmetry information in P2P lending industry. CRAs of P2P lending are a featured phenomenon in China. In order to provide information for investors making a choice of investment, Wangdaizhijia, the first CRAs of Chinese P2P lending industry commenced their business since 2011. In addition, there are also some other competitors providing similar services, such as P2PEYE, Rong 360. In other words, there are huge demands from investors in Chinese P2P lending market for clarifying operation ability of lending platforms. According to the questionnaire conducted by this research, more than 70% respondents have known CRAs of P2P lending, which shows that P2P lending investors are familiar with credit rating reports. In addition, the credit rating report of P2P lending is top three investment criteria, which indicates that credit rating reports have impact on investment decision of investors. In order to attract investors, it is estimated that a P2P lending platform will improve their business operation for pursuing high ranking. From the development of CRAs in Chinese P2P lending and results of the questionnaire, this study found CRAs could show its impact on both investors and P2P lending platforms.

## 5.3. CRAs of Chinese P2P Lending Should Be Regulated for Pursuing Objectiveness

In spite of advantages indicated as aforementioned, there are some disadvantages, for instance, CRAs may charge P2P lending platforms “advisory fee” for providing them with a better ranking on

their credit-rating report in practice. Moreover, P2P lending platforms with poor business operation have high motivation to bribe staff of these agencies for upgrading their rank and attracting investors, which may dilute objectiveness of CRAs. Moreover, there is no specific regulation from current financial authority to regulate credit-rating agencies of P2P lending. In Chapter 4, this study finds that it is necessary for developing prevention mechanism of potential corruption rather than simply relying on their motivation of pursuing reputation. Nonetheless, according to definitions of existing regulations in China, the scope of CRAs is only including those provides rating report of companies instead of platforms, which implies that existing regulation of credit-rating agencies in Chinese debt market could not imply in P2P lending. This study suggests that it is necessary to require credit-rating agencies to disclose their rating criteria for enhancing its objectiveness for further development working as a gatekeeper of P2P lending industry in China.

#### 5.4. Summary

To sum up, this dissertation mainly argued that hard-law does now show remarkable effect on reducing frauds of Chinese P2P lending. Despite literature suggest that the association self-regulation system of P2P lending in the UK should be introduced into China, this study argues that association-based self-regulation is not suitable or practical for enhancing market transparency of P2P lending in China at this moment given that the independence of industry association in China is not well established. Specifically, without independence for developing self-regulation, successful self-regulation model of P2P lending in the UK cannot be understood as a choice for implementing into China.

Rather, based on empirical study of this Dissertation, CRAs could be understood as the mechanism of reducing the gap of market information and enhancing market transparency. However, CRAs of P2P lending should be regulated by government regulation from hard-law perspective for pursuing objectiveness and establishing reliable rating system. Without objectiveness, rating report provided by CRAs could not have effect on improving market transparency. In addition, the regulatory impact of CRAs will become limited on a P2P lending platform due to lack of trust of P2P lending investors.

Overall, this research suggests the ideal regulatory model of Chinese P2P lending is co-regulation. Specifically, Chinese P2P lending is regulated by CRAs from soft-law perspective for pursuing market transparency and improving ineffectiveness of regulatory framework currently. With rating report provided by CRAs, investors of P2P lending could easily distinguish the quality of P2P lending platforms in an efficient way as shown in Figure 31. Since rating report provided by CRAs has impact on investors, a P2P lending platform will pursue a better ranking for attracting more investors, which shows the regulatory impact of CRAs. In addition, CRAs of Chinese P2P lending should be within the scope of CRAs regulation in China, especially proposed regulation of CRAs in China.

With relevant regulation, such as requirements of liability of their rating result, independence from a rated company, and disclosure of their rating criteria, the objectiveness of CRAs could be ensured for providing reliable credit rating reports for enhancing market transparency of Chinese P2P lending industry. In this regard, this Dissertation proposed the regulatory framework of Chinese P2P lending is directly regulated by soft-law and indirectly regulated by hard-law for enhancing market transparency of Chinese P2P lending and reducing frauds caused by Ponzi Scheme. Soft-law

mechanism studied in this Dissertation has formed an unprecedented approach in terms of regulation in Chinese P2P lending industry, especially how P2P lending in China is co-regulated by hard-law and soft-law work together for pursuing market transparency.

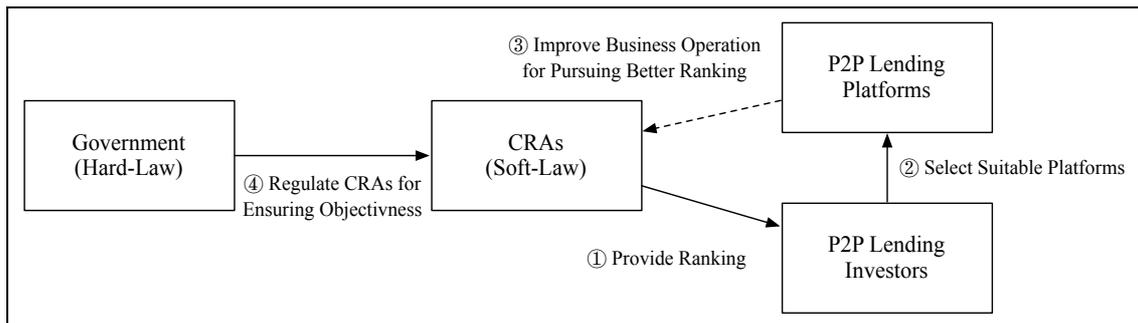


Figure 31: Proposed Regulatory Framework of Chinese P2P Lending

Source: The figure is constructed by author

Recently, Regulatory Technology, known as RegTech is a popular issue received attention from financial authorities in the world, especially its regulatory impact on Fintech. With technology, such as Artificial Intelligence, the industry of Fintech may be regulated in real time without bias caused by human. The issue, such as objectiveness of CRAs, may be easily solved. RegTech is a promising field for doing further research of addressing problems raised by this Dissertation.

Appendix 1: The Statistics of Criminal Cases in Chinese P2P Lending

1. Summary

<b>Cases</b>	37	<b>Amount (CNY)</b>	1,334,794,803.91
<b>Investors</b>	14,361	<b>Return (CNY)</b>	465,140,127.88
<b>Victims</b>	4,585	<b>Loss (CNY)</b>	1,078,075,767.04

2. Details

Area	Case Number	Company Name	Investor	Victim	Total Amount (CNY)	Return (CNY)	Loss (CNY)	Establish	Capture	Guilty
安徽	(2015)铜中刑终字第 00039 号	徽煌财富	654	455	50,362,374.58	27,404,205.37	23,821,542.47	-	20140120	20150515
广东	(2014)深中法刑二初字第 273 号	网赢天下	2153	1009	-	-	166,518,043.11	-	20131028	20150826
浙江	(2015)浙杭刑初字第 131 号	沃发投资	514	-	50,150,000.00	-	492,506,225.00	-	20141114	20151105
广东	(2014)深中法刑二终字第 731 号	通联贷	-	-	25,212,745.85	-	7,098,573.79	-	20140224	20141210
山东	(2015)泰刑三终字第 39 号	国安贷	-	600	106,941,758.60	81,376,695.29	25,565,063.31	201307??	20150305	20151227
安徽	(2015)铜中刑终字第 00038 号	华强财富	440	240	16,260,000.00	-	11,092,168.80	-	20131224	20150529
浙江	(2015)浙杭刑初字第 166 号	源本财富	1000	500	250,000,000.00	-	89,186,860.00	-	20141215	20151217
山东	(2015)莱中刑二终字第 30 号	乐网贷	1800	335	101,781,405.10	81,899,095.91	18,296,085.55	20130503	20131130	20160318
江苏	(2016)苏 08 刑终 11 号	乾坤贷	-	169	62,166,831.98	-	7,407,506.23	-	20141218	20160202
江苏	(2015)通刑二终字第 00074 号	优易网	-	45	25,508,001.10	10270013.16	15,237,987.94	-	20130202	20160328
浙江	(2015)温瑞刑初字第 247 号	德赛财富	118	-	29,429,500.00	-	13,581,794.00	20130704	20140505	20150729

深圳	(2014)深罗法刑二初字第147号	东方创投	1325	-	126,736,562.39	74719587.96	52,503,199.73	20130619	20131102	20140715
绍兴	(2015)绍虞刑初字第229号	力合创投	1205	331	51,956,361.90	10563352.06	37,843,268.51	-	20131022	20150520
安徽	(2014)明刑初字第00259号	平海金融	1003	-	106,019,684.89	84694668.28	24,015,920.18	20130607	20140319	20141223
黑龙江	(2015)香刑初字第229号	宸瀚财富	48	-	7,710,000.00	-	6,566,609.00	20130723	20141107	20150701
黑龙江	(2015)香刑初字第312号	宸瀚财富	-	-	-	-	-	-	-	-
黑龙江	(2015)香刑初字第356号	宸瀚财富	8	-	2,590,000.00	-	1,890,000.00	20130723	20150203	20150723
黑龙江	(2016)黑0110刑初53号	宸瀚财富	10	-	1,500,000.00	-	-	20130723	20140710	20160317
浙江	(2015)丽莲刑初字第645号	雨滴财富	565	-	51,161,672.90	-	8,148,391.95	20130922	20150116	20151023
大连	(2015)沙刑初字第733号	利华财富	-	-	12,570,000.00	-	11,369,260.78	201311??	20150213	20160125
山东	(2015)利刑初字第117号	皇顺贷	-	-	713,282.30	-	-	20141008	20150123	20151224
江苏	(2015)盱刑初字第00161号	宝仕金融	39	-	12,675,141.86	3,670,000.00	9,005,141.86	201309??	20140320	20150604
安徽	(2015)铜官刑初字第00009号	诚宜创投	500	89	15,342,453.08	-	2,983,134.80	20130922	20140107	20150310
上海	(2015)杨刑初字第1232号	-	-	-	-	-	-	-	-	-
山东	(2015)庆刑初字第74号	庆云双兴	175	-	3,785,080.00	2,196,635.00	1,588,445.00	20141028	20150128	20151125
北京	(2014)朝刑初字第3536号	-	-	-	-	-	-	-	-	-
南京	(2014)秦刑二初字第151号	-	-	-	-	-	-	-	-	-
浙江	(2015)温瑞刑初字第1369号	富城贷	133	-	21,590,092.00	-	8,901,913.00	20131111	20141111	20151126
广东	(2015)惠城法刑二初字第515号	中源资本	870	378	58,244,561.88	43,104,351.87	15,140,210.01	201311??	20141202	20151012
北京	(2015)朝刑初字第2551号	一元财富	41	-	5,586,000.00	-	4,359,200.00	20140430	20150124	20151216
山东	(2016)鲁0902刑初46号	兴盛贷	968	-	24,930,745.00	14241522.98	10,689,222.02	20140509	20150914	20160406

浙江	(2015)湖安刑初字第150号	汇银投资	-	360	15,610,000.00	-	9,800,000.00	201309??	20131204	20150720
山东	(2015)昌刑初字第331号	亿润贷	-	-	2,790,548.50	-	-	201409??	20150506	20160122
浙江	(2015)甬鄞刑初字第1362号	融丰创投	292	74	7,830,000.00	-	2,960,000.00	20140814	20150215	20151127
南京	(2014)秦刑二初字第153号-2	汇上盈, 丰洲盈	-	-	46,640,000.00	-	-	20120104	20130730	20150706
山东	(2015)平刑初字第91号	-	-	-	-	-	-	-	20150129	20151230
上海	(2015)闸刑初字第700号	今鑫财富	500		41,000,000.00	31,000,000.00	-	201307??	-	20151124

Appendix 2: The Survey of Credit Rating Agency of P2P Lending – Behavior of User

**1. Summary:**

Sample: 214 (randomly - 91 women & 123 men with financial interest)

Duration: From October to November 2016

Location: China

**2. Survey Content & Result:**

Chinese (Original)	English (Translated)		
<u>*Q1 您的性别</u>	<u>*Q1 Gender</u>		
男	Male	123	57.48%
女	Female	91	42.52%
<u>*Q2 有无关注或参考 P2P 网贷评级报告（例如：网贷之家，网贷天眼，融 360，贷罗盘，羿飞，社科院网贷评级报告，大公国际网贷评级报告等）？</u>	<u>*Q2 Have you ever read a credit rating report of P2P lending in China (e.g. Wangdaizhijia, P2P Eye, Rong 360, Dai Luo Pan, Yi Fei, Chinese Academy of Social Science, Dagong Credit)</u>		
是 选中/填写 跳转至 Q3	Yes (Q3)	152	71.03%
否 选中/填写 跳转至 Q5	No (Q5)	62	28.97%
<u>*Q3 最常关注或使用的 P2P 网贷评级？</u>	<u>*Q3 Which credit rating report do you mostly read?</u>		
羿飞	Yi Fei	4	2.63%

网贷之家	Wangdaizhijia	60	39.47%
大公国际网贷评级报告	Dagong Credit	12	7.89%
网贷天眼	P2P Eye	9	5.92%
社科院网贷评级报告	Chinese Academy of Social Science	13	8.55%
融 360	Rong 360	53	34.87%
贷罗盘	Dai Luo Pan	1	0.66%
<u>*Q4 除上述外，是否还有听过或参考其他的 P2P 网贷评级（多选，如没有的话可不选）</u>	<u>*Q4 Have you ever heard any other credit rating report of P2P lending? (multi-selection)</u>		
羿飞	Yi Fei	16	10.53%
网贷之家	Wangdaizhijia	64	42.11%
大公国际网贷评级报告	Dagong Credit	29	19.08%
网贷天眼	P2P Eye	42	27.63%
社科院网贷评级报告	Chinese Academy of Social Science	25	16.45%
融 360	Rong 360	57	37.50%
贷罗盘	Dai Luo Pan	6	3.95%
<u>*Q5 是否曾参与 P2P 网贷投资？</u>	<u>*Q5 Have you ever invested in P2P lending?</u>		
是 选中/填写 跳转至 Q6	Yes (Q6)	76	35.51%
否 选中/填写 跳转至 Q18	No (Q18)	138	64.49%
<u>*Q6 曾参与投资的 P2P 网贷平台名称？（多个请用分号；隔开）</u>	<u>*Q6 What is the name of the P2P lending platform you made your investment with? (please use “;” to separate platforms)</u>		

<p><u>*Q7 参与 P2P 网贷平台，累积投资金额</u></p> <p>2000 元及以下</p> <p>2001-3000 元</p> <p>3001-5000 元</p> <p>5001-8000 元</p> <p>8001-12000 元</p> <p>12001-20000 元</p> <p>20000 元以上</p>	<p><u>*Q7 How much do you already invest in P2P lending platforms?</u></p> <p>Under 2,000 CNY</p> <p>2,001-3,000 CNY</p> <p>3,001-5,000 CNY</p> <p>5,001-8,000 CNY</p> <p>8,001-12,000 CNY</p> <p>12,001-20,000 CNY</p> <p>More than 20,000 CNY</p>		
<p><u>*Q8 P2P 网贷投资依据（多选）</u></p> <p>直觉判断</p> <p>亲朋好友推荐</p> <p>P2P 网贷平台网站公告信息</p> <p>P2P 网贷评级</p> <p>羊毛党人士</p> <p>其他</p>	<p><u>*Q8 What is the criteria of your investment of P2P lending? (multi-selection)</u></p> <p>Intuitive judgement</p> <p>Recommended by friends</p> <p>Disclosure information provided by a P2P lending platform</p> <p>Credit rating report of P2P lending</p> <p>Yangmaodang</p> <p>Other</p>		
<p><u>*Q9 您认为使用 P2P 网贷评级，对于投资是否有所帮助？</u></p> <p>是</p>	<p><u>*Q9 Do you think that credit rating reports having positive impact on your judgement of investment?</u></p> <p>Yes</p>		

否	No	4	5.26%
<u>*Q10 您认为 P2P 网贷评级具体帮助为何？（多选）</u>	<u>*Q10 What is the concrete improvement provided by credit rating reports? (multi-selection)</u>		
避免踩雷或及早抽身（如：e 租宝或 e 速贷等）	Detect risks	39	51.32%
评级榜上有名的网贷平台收益确实很好	The ranking is reliable	42	55.26%
帮助我评估适合之投资标的（如：高风险高收益或保守稳健）	Improve my portfolio	47	61.84%
其他	Other	0	0%
<u>*Q11 您对于 P2P 网贷评级的信任度？</u>	<u>*Q11 Do you trust the rating result provided by credit rating agencies of P2P lending?</u>		
非常信任	Highly trust	4	5.26%
信任	Trust	38	50.00%
普通	Normal	29	38.16%
不信任	Distrust	5	6.58%
非常不信任	Highly distrust	0	0.00%
<u>*Q12 您认为当前 P2P 网贷评级行业有什么风险？（多选）</u>	<u>*Q12 What are your opinions of current credit rating agencies of P2P lending? (multi-selection)</u>		
P2P 网贷评级机构涉及“收取回扣，浮报评级”	Ratings shopping	35	46.05%
P2P 网贷评级过于“主观”，缺乏科学标准	Lack of scientific analysis	45	59.21%
P2P 网贷评级机构对于“不给回扣者，给予不利评价”	Adverse impact on non-client P2P lending platform	33	43.42%
不同的 P2P 网贷“评级存在很大的差异”	Split Rating	31	40.79%

<p><u>*Q13 您认为当前 P2P 网贷评级行业还有什么风险？（多选）</u></p> <p>P2P 网贷评级行业被少数几家 “垄断，不利行业竞争”</p> <p>P2P 网贷评级 “无法预期或避免风险”</p> <p>P2P 网贷 “评级变动太大” （如：当月 A 改成下个月 C）</p> <p>P2P 网贷评级于事件爆发时，“删除过往不正确评价”</p> <p>其他</p>	<p><u>*Q13 What are your other opinions of current credit rating agencies of P2P lending? (multi-selection)</u></p> <p>Oligopoly with insufficient competition</p> <p>Lack of ability to detect risks</p> <p>Instable rating</p> <p>Dishonest</p> <p>Other</p>		
<p><u>*Q14 您所投资的 P2P 网贷平台曾经受 P2P 网贷评级的影响（例如：评级变佳收益变好，评级变差纷纷提现）？</u></p> <p>因为评级变佳，有正面影响，如：收益变好 选中/填写 跳转至 Q15</p> <p>因为评级变差，有负面影响，如：纷纷提现 选中/填写 跳转至 Q15</p> <p>没有影响 选中/填写 跳转至 Q16</p> <p>我不知道 选中/填写 跳转至 Q16</p>	<p><u>*Q14 Is there any impact caused by a credit rating report on a P2P lending platform you invested before?</u></p> <p>Positive impact (Q15)</p> <p>Negative impact (Q15)</p> <p>No impact (Q16)</p> <p>I do not know (Q16)</p>		
<p><u>*Q15 受影响的 P2P 网贷平台名称？（多个请用分号；隔开）</u></p>	<p><u>*Q15 What are the name of P2P lending platforms influenced by a credit rating report?</u></p>		
<p><u>*Q16 您认为 P2P 网贷平台信息披露是否不够透明？</u></p>	<p><u>*Q16 Do you think the information disclosed by a P2P lending platform is insufficient?</u></p>		

是	Yes	58	76.32%
否	No	18	23.68%
<u>*Q17 P2P 网贷平台虽然有披露信息，是否过于艰涩难懂？</u>		<u>*Q17 Do you think the information disclosed by a P2P lending platform is obscure?</u>	
是	Yes	56	73.68%
否	No	20	26.32%
<u>*Q18 您的职业</u>		<u>*Q18 Your occupation</u>	
<u>*Q19 个人月收入</u>		<u>*Q19 Monthly salary</u>	
在校学生，没有收入	I do not have salary	16	7.51%
2000 元及以下	Under 2,000 CNY	23	10.80%
2001-3000 元	2,001-3,000 CNY	36	16.90%
3001-5000 元	3,001-5,000 CNY	78	36.62%
5001-8000 元	5,001-8,000 CNY	33	15.49%
8001-12000 元	8,001-12,000 CNY	18	8.45%
12001-20000 元	12,001-20,000 CNY	8	3.76%
20000 元以上	More than 20,000 CNY	1	0.47%
<u>*Q20 教育程度</u>		<u>*Q20 Education</u>	
初中及以下	Elementary school or junior high school	3	1.41%
高中	High school	17	7.98%

大专	Colleague	74	34.74%
本科	Undergraduate program	104	48.83%
硕士及以上	Master or doctor	15	7.04%

### Appendix 3: Publications during Doctoral Program

#### **Book and Report Publications**

1. Co-Author (responsible for regulation part of Japan, Korea, Hong Kong and Taiwan), **The Asia-Pacific Alternative Finance Benchmarking Report**, Cambridge Centre for Alternative Finance, Judge Business School, University of Cambridge
2. Contributor, **The Real Peer-to-Peer Lending: Innovation**, Risk and Supervision, Chinese Academy of Social Sciences (Chinese Government Think Tank)
3. Contributor (responsible for Chapter 4: Crowdfunding in Asian countries and its interaction with citizenship), **Law Between Buildings: Emergent Global Perspectives in Urban Law**, Fordham Law School

#### **Conference Publications**

1. **Crowdfunding in Asian countries and its interaction with citizenship**, The 2nd Annual International & Comparative Urban Law Conference (held by Fordham Law School and Sorbonne Law School in Paris), June 29, 2015
2. **Crowdfunding and its recent development in Asia**, The 4th East Asian Law & Society Conference (held by East Asian Law & Society at Waseda University in Tokyo), August 2015
3. **The Recent Development of Equity-Crowdfunding in Japan and Taiwan**, The 1st Internet Finance Conference (held by China University of Political Science and Law), October 18, 2015
4. **Crowdfunding and its Interaction with Urban Development**, The 1st IASC conference on the Urban Commons (held by Fordham Law School, the Libera Università degli Studi Sociali, the International Association for the Study of the Commons, and the Laboratory for the Governance of the Commons), November 6, 2015.
5. **Equity-Crowdfunding and its Legal Problems in Taiwan**, The 19th National Technology Law Conference (held by Law School of National Chiao Tung University in Taiwan), November 19, 2015.
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