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On the Development of Financial Supervision from the Perspective of Digital Finance

-- Take the IPO of Ant Group as an Example

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Abstract

Ant Group is the largest financial technology unicorn enterprise in China and the largest mobile payment platform in the world. The suspension of IPO in October 2020 attracted great attention from the market. The most concerned business of Ant Group is asset securitization (ABS). Through the securitization of micro credit assets such as Huabei and Borrowing, Ant Group has changed from billions of capital to hundreds of billions of loans, realizing hundreds of times of leverage, and the related financial products have flowed into the financial market to realize risk transfer. The continuous innovation of financial science and technology has brought great financial risks while promoting the development of social economy. This paper takes Ant Group as an example to analyze the development ideas of financial supervision from the perspective of digital finance, and explore countermeasures to prevent systemic financial risks in advance.

Keywords

Digital Finance; Financial Supervision; Financial Risk; Ant Group; Asset Securitization.

1. Introduction

At present, the whole society is in the accelerated period of digital transformation. As the basic industry of the national economy, the financial industry has always been in the forefront of industrial digitalization. New technologies such as big data, cloud computing, artificial intelligence, and blockchain are enabling financial businesses in an all-round way. The foundation for digital transformation of the financial industry is becoming more and more solid. The demand of the real economy for financial services is changing towards efficiency, boundaries, accuracy, and personalization. In the face of the unprecedented changes in the world in a century and the interwoven impact of the COVID-19 and the global pandemic, the world economic recovery is facing many difficulties. How to properly handle the relationship between economic development and financial innovation, effectively prevent and resolve financial risks is a major problem faced by China's financial regulatory authorities. Actively exploring the innovative supervision practice of digital finance is a major issue that we must seriously face. This paper takes the case of Ant Group's IPO being called off as an example to discuss the opportunities and challenges brought by the digitalization of the financial industry to financial supervision and the countermeasures of financial supervision from the perspective of digital finance to prevent the occurrence of systematic financial risks.

2. The Whole Story of Ant Group's IPO was Called Off

Ant group is the parent company of Alipay and the world's leading financial technology open platform. With the corporate vision of "making credit equal to wealth", Ant Group focuses on building an open ecosystem, assisting the financial industry and partners to move towards the "Internet" according to the "Internet Promotion Plan", and bringing technology and financial

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services to SMEs and individual customers. The group has Alipay wallet, Alipay yu'ebao, zhaocaibao, ant capital, e-commerce financial institutions, ant Huabei, sesame credit and other sub business segments.

Ant Group announced its plan on July 20, 2020 to be sold and listed in Shanghai Stock Exchange and Hong Kong Stock Exchange at the same time, and submitted its prospectus on August 25 at the same time. On September 18, the municipal party committee of the Shanghai Stock Exchange allowed Ant Group to go public (first) on the Science and Technology Innovation Board. On October 19, the IPO of Ant Group in Hong Kong, China was approved by the CSRC. On October 26, Ant Group completed its IPO inquiry.

The originally satisfactory listing procedure was changed on October 24. On the same day, the controlling shareholder of Ant Group stated at the Bund Financial Summit in Shanghai: "There is no systematic risk in China's finance." Because "there is no system", our finance is still a "youth" and has not yet fully matured. On November 2, the CBRC issued the Interim Measures for the Administration of Online Small Loan Business (Draft for Comments), which clearly stipulated that cross provincial development and joint loan contributions should not be less than 30% of the red line. On the same day, the People's Bank of China, China Securities Regulatory Commission, China Banking Regulatory Commission and the State Administration of Foreign Exchange interviewed as the four senior managers of Ant Group. The next day, Shanghai Stock Exchange suspended the listing of Ant Group on the Science Innovation Board, and Hong Kong Stock Exchange released a message to suspend the H-share listing of Ant Group. On December 26, the four ministries and commissions again interviewed Ant Group and asked Ant Group to establish a working group for rectification, fulfill the commitment and regulate the credit business. In this regard, the listing of Ant Group was announced to enter the rectification process.

3. Asset Securitization (ABS) Process of Ant Group

Asset securitization is a process of issuing asset backed securities (ABS) on the basis of credit rating through structured design, with the future cash flow of the underlying assets as the payment support. The basic process of asset securitization is as follows: the original equity owner (i.e. the promoter) sells the underlying assets to a Special Purpose Vehicle (SPV), and the SPV collects the underlying assets into an asset pool, and then uses the cash flow generated by the asset pool to pay off the securities issued by it. The main participants in asset securitization include: original equity holders, investors, SPVs, underwriters, trust companies, credit enhancement agencies or guarantee agencies, credit rating agencies, custodians, accounting firms and law firms. The main purpose of asset securitization is to realize the assets lacking liquidity in advance, thereby increasing asset liquidity.

Ant Group has borrowed 3 billion yuan of capital through Huabei and Borrowing, forming a debt of 3 billion yuan. The bonds are designed as three layers of ABC, in which layer A accounts for 70%, that is, 2.1 billion yuan, and the fixed interest rate is 6.1%; Layer B accounts for 25%, that is, 750 million yuan, and the fixed interest rate is 7.5%; Only 5% of the floor C, that is, 150 million yuan. Among them, Level C is a high-risk and high-yield project, which is often digested by Ant Group, that is, cross purchased by subsidiaries. But the money used for cross buying C is also raised from the market, and the risk is transferred to investors.

The last one is security. Share C assets guarantee share B assets, and share B assets guarantee share A assets. If there is a loss, it is to lose C first, then B, and finally A. Class A assets are the safest, while Class C assets are high-risk and profitable. In this way, Ant Group will sell Class A and B shares of assets to major financial institutions in the market through asset securitization, and the refinanced funds can continue to be used for credit, forming a cycle, and the company's leverage ratio continues to grow.

According to the statistics of Huang Qifan, the former mayor of Chongqing, Ant Group has issued loans with more than 3 billion yuan of capital through the asset securitization cycle for 40 times in a few years, and more than 300 billion yuan of capital has been issued, forming hundreds of times of high leverage. If it is allowed to develop, all investors and financial institutions will face huge losses and systematic financial risks once the Ant Group's capital chain is in trouble.

4. Thoughts on Financial Supervision from the Perspective of Digital Finance

The emergence of Internet financial innovations such as Ant Group has challenged the traditional financial regulatory system. On the one hand, the formulation and implementation of traditional monetary policies require accurate measurement of asset flows, which is distorted by new financial instruments. Therefore, traditional monetary policies such as discount rate and deposit reserve rate are difficult to play a role. On the other hand, financial innovation increases the difficulty of financial supervision, aggravates the uncertainty of financial activities, increases financial risks, and increases the difficulty of financial supervision. However, it is the emergence of financial innovation that makes financial supervision activities constantly seek more effective systems and operation methods, thus promoting the continuous reform of the financial supervision system. The following will take Ant Group as an example to analyze the domestic financial supervision ideas and main considerations.

4.1. Core Considerations of Financial Regulators

The core consideration of the financial supervision department mainly involves credit risk, systematic risk and compliance risk of related transactions.

4.1.1. Credit Risk

The credit risk of Ant financial information service comes from two business processes: online loan and ABS asset securitization. The biggest profit source of Ant Group's main business is online loan. Ant's prospectus shows that 98% of the debt account balance contributed by the high-tech service platform is loans or asset securitization in the specific financial industry. The leverage ratio, including the ant aided loan and the joint loan, exceeded 60 times, that is, the ant could pry up to 1.8 trillion yuan of joint loan with more than 30 billion yuan of property.

Online credit risk is high. Because the loan of Ant Group has a small share in the joint loan, once the loan breaks the contract, as long as it undertakes less than one tenth of the obligations, most of the risk of breaking the contract will be borne by financial institutions. However, private banks that purchase ant loans usually have poor risk control and do not have sufficient working ability to distinguish the quality of online loan assets. They usually simply agree with the quality of Ant Internet big data loan platform, and then go to the market to make joint loans with Ant Group. In addition, compared with traditional lending banks with strict credit management procedures, online lending is not good at manipulating "risk prevention and control measures". Once loans are granted, the supervision system of online loans is almost absent. Take "Ant Flower" as an example, there are various ways to cash in loans. In addition, ABS business process has high credit risk. Once ABS shares are sold, the buyer should bear all risks, and Ant is not responsible. Compared with the loan business, the ABS business process of Ant Group does not even require 1% - 5% co loan capital investment. Alibaba only designs and markets ABS products. In theory, ABS with unlimited leverage can complete unlimited off balance sheet revolving loans. In fact, before the 2008 financial storm, foreign commercial banks also defined risk in this way.

4.1.2. Systemic Risk

Ant Group, like all financial service companies, the longer it is established, the more capable the service platform will be to sell more high-risk properties to users based on its own well-known

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brands. By the time the problem is found, the scope of the service platform is large enough to cause systematic risk, which is the same as the problems encountered by other "too big to fail" financial industries around the world. The entire financial system is interconnected. Once a business process loses money, it must be made up by others, which will eventually endanger the entire financial system.

The Administrative Provisions on Asset Securitization Business of Securities Companies was implemented at the beginning of 2013, providing a policy basis for Internet small loan enterprises to promote small loans on a large scale based on the benefits of asset securitization. By the end of 2020, the operating scale of Internet technology consumer credit loans has increased from 6 billion in 2013 to about 31.5 trillion. During this period, Ant Financial (Group) took advantage of technical data information to seize opportunities and develop steadily. However, this rapidly expanding Internet financial credit can hardly be accurately identified, captured and controlled under the supervision mechanism, and it is very easy to cause rapid Pro cyclical credit expansion, foam accumulation, counter cyclical centralized loan collection, financial repression and other conditions. At the same time, there are many associated companies in the asset management plan, which covers the risk prevention and control measures and expands the probability of property risk exposure spreading in the financial system. In addition, Internet technology microfinance depends on a single risk control measure. In the whole process of securitization of micro loan credit assets, the key participants are financial institutions, securities companies, etc. They rely heavily on Ant Group's corporate credit rating, personal credit identification entity model and risk management and control capabilities. Ant Group is the initial shareholder. Once the initial shareholder has risk prevention and control measures or credit risk, with the current market capacity and relatively similar operating mode, the impact on China's financial system will be no less than the impact of the US subprime mortgage crisis.

4.1.3. Compliance of Related Transactions

The relevant regulatory authorities have clearly put forward rectification requirements for the five key business areas of Ant Group. One of them is to set up a financial holding company in accordance with laws and regulations, strictly abide by the control regulations, ensure sufficient assets, and manage related transactions in compliance.

From Ant Group's prospectus, we can see that Ant Group's related parties and related transactions show the following characteristics: First, there are many regular related transactions, with up to 16 related parties such as Alibaba Group and online banking; Second, the amount of connected transactions is large. In 2017, 2018, 2019 and January June 2020, the amount of recurring related party transactions was equal to 14.59%, 16.54%, 15.85% and 15.14% of the main business income in the consolidated financial statements respectively; Third, the related party transactions are complex, and there are many types of service project transactions, such as asset transfer, transfer of intangible asset amortization ownership, equity financing and other related party transactions. Fourth, the current pricing policies for various related party transactions are not established, and are published based on the discussion of related parties.

However, numerous related party associations and many related transactions have buried potential security risks for many potential problems.

First, the problem of agency. Large shareholders or controlling shareholders are likely to do all kinds of reasonable, legal or illegal acts for their own rights and interests, and directly or indirectly move their properties and profits out of the enterprise. The complicated correlation and related transactions can make the migration of property and profits more hidden.

Second, the fairness of the bid price of related transactions. To achieve the fairness of related party transactions, we should follow the separate transaction standard, that is, there will be no non related parties arising from manipulation of transactions, which is usually referred to as the sales market. However, many new economic systems, especially the network economy, are difficult to find thorough contrast and controllability. This gives a lot of space for transfer pricing allocation of related transactions.

Third, conceal related transactions. The financial characteristics of the Internet coexist, and it is easy to confuse the boundaries between individual credit intermediary companies and information content intermediary companies. In this case, it has the ability to hide the related party transactions of equity financing assets as given related party transactions, thus avoiding the regulatory space of the financial system.

4.2. Countermeasures for Financial Supervision in the Context of Big Data

The rapid development of financial technology industry and continuous innovation in the financial field have increased the difficulty of financial supervision, which is not conducive to effective financial supervision. We all hope that we can strictly prevent financial risks before they occur, so as to avoid financial market turbulence and economic losses caused by risks. Therefore, whether financial supervision is forward-looking is particularly important. Anticipating the risk crisis prospectively and putting forward solutions in advance for effective prevention are the most effective and important ways to reduce the non-performing loan rate of the financial industry, reduce financial risks and stabilize the financial market.

4.2.1. Improve the Financial Security Legislation

Incorporate the construction of laws and regulations related to financial security into the national security legislation, and ensure that there are laws and regulations to follow in the supervision and governance activities in the field of financial security. Through the establishment and improvement of financial regulatory rules, the activities of emerging financial institutions such as financial technology platforms and large online payment enterprises will be included in the regulation, legal businesses will be protected according to law, "gray areas" in digital financial businesses will be eliminated, strict market access and exit mechanisms for the digital financial industry will be established, and industry self-regulation will be strengthened. We will promote financial technology platform enterprises to return to their roots and play a greater role in serving the real economy.

4.2.2. Strengthening the Supervision of Financial Technology Innovation

The traditional financial supervision highly depends on the supervision objects. However, with the development of the third-party payment platform, i.e. online credit service system, the supervision objects are very complex, and the requirements for financial regulators and the difficulty coefficient of supervision are also significantly improved. In the information age of the Internet of Everything, big data analysis has gradually become the core method for financial regulators to implement supervision. Therefore, to meet the needs of social and economic development, upgrading big data governance methods is also the only way to improve the effectiveness of supervision and strengthen supervision.

4.2.3. Strengthen Data Governance and Whole Process Management

4.2.3.1. Data Entry

Strengthen the process specification of data collection, fully inform customers in advance, and clearly inform them. Recently, Ant Group has updated the user notification document, optimized the content and format of the document, and made it easy for customers to read and understand the relevant content.

4.2.3.2. Data Storage and Application

Ant Group adopts a large and medium platform system architecture, and the data is also centralized in the middle platform for unified management, so as to realize the data sharing of

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various business lines. The licensed financial institutions under Ant Group need to store data according to the corresponding regulatory requirements, or need to distinguish the business data of each subsidiary. The storage and application of the customer's personal information shall be approved by the customer, and Ant Group shall also allow the customer to propose the right to modify and delete the information.

4.2.3.3. Data Export

Ant Group needs to continuously improve system security to ensure that customer information is not disclosed. When sharing data with partners, desensitization data or multi-party security computing and other technologies are used to ensure that the data is not local.

4.2.4. Standardize Personal Credit Investigation Business

Promote data value sharing through technology and system design, and improve the social credit system. Ant Group has strong competitive barriers in terms of big data sources and credit data accumulation, does not rely on external data, and is basically self-sufficient because of its weak willingness to share data externally. The follow-up supervision will strengthen the promotion of the construction of the social credit reporting system, incorporate the loan business data into the credit reporting system, and improve the risk control capability of the whole industry. On the premise of ensuring that the data does not go out of the domain, strengthen the joint modeling with cooperative financial institutions to share the data value; Promote data capitalization, reasonably price data, and improve the willingness of the head platform to share data.

When large science and innovation enterprises with data assets, discourse power, technological advantages and capital advantages penetrate into all aspects of national life, comprehensive supervision has become an inevitable goal. However, we should not blindly strengthen financial supervision and try to avoid the strange circle of "If it's messy just management, Strong management will die, Active once released, Excessive activity will lead to chaos ". We should reasonably implement appropriate regulations and policies for different financial institutions in different periods through big data analysis, and try to find a balance between stabilizing the market and encouraging market innovation, so as to promote the steady and rapid development of domestic finance.

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