

Improvement of China's legal system of systematized cross-border payment supervision under the background of digital economy

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Abstract: *The use of systematic regulation of cross-border payment systems is a necessary tool for countries pursuing currency internationalisation, and an important pillar for the internationalisation of their currencies. Currently, the emergence of new payment models represented by third-party payments and digital currencies in China's cross-border payments has impacted the current regulatory approach, leading to the characteristics of unclear regulatory subjects, inadequate regulatory approaches and unsound regulatory bases in practice. To this end, the legislative level of regulatory documents should be gradually raised by clarifying the responsibilities and rights between the current cross-border regulatory bodies. In this way, we can clarify the cross-border regulatory subject of third-party payment and digital currency, and build an effective top-level regulatory laws and regulations design.*

Keywords: *digital economy, cross-border payments, third-party payments, digital currency*

1. Introduction

Cross-border payments are an important part of China's trade globalization and the development of the Belt and Road. At present, with the rapid development of digital economy technology, a new pattern has emerged in China's cross-border payment sector, with the addition of China UnionPay and the Cross-border Interbank Payment System, as well as third-party payments, private digital currencies, and national digital currency cross-border payment systems. The system has been expanded to include third-party payments, private digital currencies, and national digital currencies. Although the proportion of third-party cross-border payment systems and cross-border digital currency payment systems in the overall cross-border payment system is still small, this payment method, which is different from the traditional cross-border payment system, is breaking through the established financial regulatory system in China. From the perspective of existing research, the theoretical research on payment regulation is characterized by a shift from the regulation of provision for third-party payments to the regulation of digital currencies, with relevant research showing a certain degree of duplication and homogenization, and the research on cross-border payments mainly focusing on a specific area of third-party payments or digital currencies, with a blind spot for the development trend of multiple subjects of cross-border payments, i.e. the current financial regulation. The current centralized regulatory model of financial supervision can no longer adapt to the current trend of decentralisation of the cross-border payment system, and the new cross-border payment system has already transformed from sectoral operation to mixed operation. Admittedly, the aforementioned studies have also laid some theoretical foundation for research on the systematization of cross-border payment regulation, but both the money laundering and terrorism-related problems brought about by third-party cross-border payments "and the digital currency payment system, which has been hailed as an infrastructure that may substantially change the payment clearing system, financial markets and even the transmission mechanism of monetary policy."^[1] all highlight the problems of unclear subjects, inadequate approaches, and unsound bases in the regulation of cross-border payments that need to be addressed in China.

2. Major problems in the regulation of China's cross-border payment system

2.1 Unclear regulatory body for cross-border payments

China's current regulatory system for cross-border payments adopts a centralized regulatory model, with specific regulation of cross-border payment practices by specialized financial departments such as the China Banking and Insurance Regulatory Commission and the China Foreign Exchange Bureau,

through a sectoral approach. The above regulatory approach is very effective for cross-border tandem payments where UnionPay is applicable, but the tandem payment model requires multiple flows of funds to reach the target account, and confirmation is required at each stage of the flow to continue the flow until it reaches the receiving account, with a fee charged at each stage, resulting in inefficient transfers and high fees. As a result, new technological payment systems that are more convenient as well as have lower fees than tandem payments have now arisen, such as cross-border third-party payments represented by Alipay and CaiPay. In 2018 alone, the cumulative total of combined third-party payment transactions reached RMB 318.59 trillion. [2] At the same time, private digital currency payment systems represented by USDT stablecoins and those issued by central banks of countries other than China are also showing a trend of replacing traditional cross-border payment systems in the global cross-border payment system [3].

However, there are two sides to everything, and although China's Non-Financial Management Measures introduced in 2010 defined third-party payments as a non-financial system, in practice third-party payments have become an internet platform that provides a variety of financial services such as funds, balance funds, customer reserve funds and cross-border transfer functions. As a result, the "non-financial institution" nature of non-bank payment service providers has led to inconsistencies in the simple application of the existing financial regulatory regime and has resulted in a lack of clarity regarding their legal status in the foreign exchange management system. At the same time, due to the ambiguous nature of the services provided by third-party payment systems, they are not only subject to the supervision of the People's Bank of China, but are also subject to the regulatory obligations of the Foreign Exchange Bureau and the tax authorities. [4] The above are the main reasons for the lack of clarity in practice as to the subject of regulation when it comes to third-party cross-border payments.

Digital currencies also suffer from a lack of clarity on the subject of cross-border payment regulation. In cross-border payment practice, digital currency systems are divided into private digital currencies and central bank digital currencies. Private digital currencies are further divided into stable and non-stable coins. For example, Bitcoin (BTC) and Ethereum (ETH) show market fluctuations with the US dollar exchange rate, and the digital stable coin, Tether (USDT), whose exchange rate remains consistent with the US dollar for a long time [5]. Digital currencies differ from third-party cross-border payment models in that they are special in that they can themselves be used as a means of settlement for cross-border payments, thereby expanding the boundaries of cross-border payments. Different digital currencies also have different "status treatment", as private digital currencies in China are already considered virtual property, while the digital RMB issued by the Chinese central bank will be defined as legal tender by relevant laws and regulations in the future. In fact, whether digital currencies have the function of money in law is still the focus of controversy in academic circles, and a debate has formed between the "currency theory" and the "non-money theory". From an international perspective, private digital currencies in China are still active in the cross-border payment market, and the "one-size-fits-all" legal definition of private digital currencies is still controversial in academic circles. Once a digital currency is defined as not being a currency, it will not be regulated by the People's Bank of China; conversely, it will be regulated by the People's Bank of China; but at present, China's digital currencies as a whole are still in a situation where the regulatory body is unclear.

2.2 Inadequate regulatory approach to cross-border payments

Due to the rapid development of the digital economy, which has greatly impacted the way established cross-border payment systems are regulated, there are difficulties in applying the system in the face of mixed third-party cross-border payments and digital money economies. [6]

Firstly, although China can still adopt the traditional commercial bank supervision approach and implement the institutional supervision model for third-party cross-border payment regulation, this model focuses on the ex-ante supervision of market access, controlling and avoiding financial risks through the issuance of payment licenses, and has introduced separate "Non-Financial Management Measures" to address the recurring problems of money laundering and illegal diversion of provision funds in third-party payments. In addition, a separate Non-Financial Regulation was introduced to address the recurring problems of money laundering and illegal diversion of provision funds. In fact, this policy of defining third-party payments as non-financial institutions, paired with institutional regulation, is prone to cross-regulation in the specific business of third-party payments that operate in a mixed industry, thus giving rise to the problem of inadequate regulation. [7]

Second, the use of digital currencies for cross-border payments also has the problem of inadequate regulation. For example, private digital currencies, including stable coins anchored to the U.S. dollar, have special characteristics compared to traditional proxy cross-border payments, i.e., they rely on a

"distributed system" to allocate system operation functions such as verification and record information, and maintenance of the system to various entities entitled to participate in the operation of the system. This decentralized feature can enhance the credibility of information in the past centralized system settlement and ensure the integrity and security of clearing information. Despite the convenience and security advantages of digital currencies with blockchain nature, their anonymity inherently carries the property of escaping regulation. Therefore, in China's Bitcoin cases, Bitcoin is considered to be virtual property, and a "one-size-fits-all" regulatory prohibition is adopted. This prohibitionist regulatory approach is likely to have the negative effect of stifling innovation in the payments sector. For the digital currency issued by the central bank, China's white paper "Progress in the Research and Development of China's Digital RMB" makes it clear that it has monetary functions, and has value characteristics and legal reimbursement. This means that it adopts a different centralized model from private digital currencies and has the possibility of gaining circulation. However, due to the limitations of the white paper, which is not clear about the regulatory approach, the central bank's digital currency regulatory approach is still in an unfocused situation. As a result, a "regulatory vacuum" has been created to some extent, which has led to the brutal growth of digital currencies in the past two years, and even a large number of cases of illegal fund raising and fraud in the name of digital currencies [8].

2.3 Inadequate regulatory basis for cross-border payments

Table 1: Summary of major regulatory policies covering cross-border payments

Release date	Mainly related to cross-border payment regulatory policies	Regulatory bodies	Policy level
2010.06.14	《Non-Financial Management Practices》	The People's Bank of China	Administrative Rules
2013.12.05	《Notice on the prevention of bitcoin risk》	People's Bank of China, Securities Regulatory Commission, Ministry of Industry and Information Technology, Banking and Insurance Regulatory Commission	Normative documents
2019.04.29	《Foreign Exchange Management Measures for Payment Institutions》	Foreign Exchange Office	Policy level
2019.12.27	《Foreign exchange guidance》	Foreign Exchange Bureau, Ministry of Commerce, CBRC	Normative documents

China has established laws and regulations for the regulation of the entire payment system, covering various aspects such as market access, anti-money laundering and management of customer reserve funds, but the regulatory documents are at a low level, mostly normative documents and administrative regulations (see Table 1). Most of the relevant regulatory documents issued are macro in nature, while specific regulatory units have not issued relevant rules, resulting in a lack of sound basis for regulating specific issues. The traditional payment regulatory system constructed in China in the past "adopted an institutional regulatory model mainly applicable to traditional financial institutions and their related businesses under the pattern of sectoral operation and regulation, which can effectively improve regulatory efficiency, reduce regulatory costs and avoid regulatory duplication or regulatory vacuum." [9] And the digital economy represented by the digital currency and the third-party cross-border payment system mixed business operation emerged, causing the original regulatory laws and regulations to be confusing and unable to legally characterize the relevant areas as well as timely confirmation of regulatory subjects in a short period of time. Moreover, with the further development of digital currencies and third-party payments, they have crossed over various financial fields, creating huge financial risks. The government's approach to regulating the fintech sector has gone from lax to extremely cautious. For example, Bitcoin has been defined as a virtual product and ICO announcements have directly banned private digital currency exchanges. The development of China's fintech sector has been affected by the lack of laws and regulations governing cross-border payments.

3. Suggestions for specific measures to improve the supervision of China's cross-border payment system

3.1 Clarify the regulatory body of the cross-border payment system

Currently, Chinese academic researchers have put forward many useful theories on the regulatory systems of third-party payments and digital currencies, but most of them have studied the technical attributes of both, analysing whether the risks of technical aspects and personal information leakage can be overcome, while little research has been conducted on the measures to regulate the ambiguous behaviour of regulatory bodies. For this reason, the systematic regulation of payments requires a restructuring of regulatory thinking.

3.1.1 Clarify that the responsibilities of the regulator are commensurate with its powers

The prerequisite for the construction of effective regulation is that rights and responsibilities must correspond. This will enable the regulatory body to be clear. Based on the experience of other countries, there are advantages and disadvantages to the functional regulation of finance as practiced in the UK and the institutional model of regulation as practiced in the EU. [10] Because, in order to avoid third-party cross-border payments and digital currencies straying from the current regulatory framework, a macro-prudential regulatory approach is preferable. One is to establish a regulatory model in which the People's Bank of China and the Foreign Exchange Bureau of China interface with each other. When the PBOC or the Bureau of Foreign Exchange encounters specific regulatory issues, the department will be connected to overcome the drawbacks of the past division of regulation that makes it difficult to deal with the current mixed business of third parties. Second, to strengthen the regulatory mechanism of the industry. According to the regulatory experience of Singapore and the United Kingdom, third-party cross-border payments and digital currencies, as a new type of technological payment means, the path of rule of law regulation alone is far from sufficient and needs to focus on industry self-regulation. "Industry associations are social intermediary organisations and self-regulatory industry management organisations, acting as a bridge and link between the government and enterprises, and playing the role of service, self-regulation, coordination and supervision within the industry." That is, it plays a supervisory system built within the industry for self-monitoring and self-evaluation, creating an important role for industry associations in the development of the industry, promoting industry initiatives for self-regulation and internal oversight of undesirable cross-border payment practices, and creating a clear regulatory body in the triad.

3.1.2 Building a common regulatory system with extra-territorial countries

Due to the greater convenience of cross-border payments, the operations of third-party cross-border payments can easily become a major means of illegal transfer of funds, such as "money laundering and terrorist activities". [11] This threatens the healthy development of third-party cross-border payments in China. China's third-party cross-border payment system not only needs to connect with the regulation of the Anti-Money Laundering Law of the People's Republic of China, but also needs to clarify the anti-money laundering rules in cross-border payment services in the Measures for the Administration of Anti-Money Laundering and Anti-Terrorist Financing of Payment Institutions. The core regulation of anti-money laundering is a two-way regulation, which will require Chinese regulatory bodies such as the People's Bank of China to form a regulatory alliance with other countries' regulatory bodies to jointly regulate money laundering in third-party cross-border payments and eliminate the use of the act for illegal crimes.

3.2 Building an effective regulatory approach

Currently, digital currencies are divided into private digital currencies and central bank digital currencies. China has adopted a prohibitive regulatory approach for both private digital currencies and US dollar-anchored stable currencies, while China's central bank digital currency has been operating on a pilot basis in Suzhou and Beijing. Therefore, the regulatory policy for private digital currencies and central bank digital currencies should first be defined in terms of legal attributes. This paper adopts the definition of the "new currency theory"[12], which is the current mainstream theory in the academic community, and digital currencies, as incorporeal objects, still belong to the property attribute of money.

3.2.1 Private digital currency regulatory system restructuring

From the practice of countries around the world, the current private digital currency, has been distinguished from the imperfect market of bitcoin's new coin, namely the stablecoin TEDA coin and the

scales coin issued by the FACEBOOK company, this kind of digital currency anchored to the US dollar, become the mainstream of cross-border transactions. The current global popularity of private digital currencies should therefore be transformed into a prohibitionist regulatory orientation, as blockchain payment systems will not only be less profitable under intense regulatory pressure, but their ability to innovate will also be hindered, which is contrary to China's multiple "going out" policies such as Belt and Road. And outright prohibitive regulation has already hindered the development of digital currency payment systems for fintech companies in China. Because this, is based on the decentralization of private digital currencies, priority should be given to the development of technical regulatory areas and the construction of a regulatory system driven by core technology. In addition, based on the current provisions of the Electronic Commerce Law for electronic payments, the administrative regulations and normative documents for digital currency payment institutions should be set out in detail, so that regulatory bodies can properly guide the development of institutional compliance by following the relevant provisions. Her regulatory policy should guide China's digital ecology towards the global frontier and further clarify the orientation of current laws and regulations. The regulatory policy should guide China's digital ecology towards the global frontier and further clarify the orientation of current laws and regulations.

3.2.2 The People's Bank of China's Digital Currency Regulatory System Reorganized

Compared to private digital currencies, the issuer of China's central bank digital currency represents the credit of the state. In cases concerning Bitcoin in China, Chinese courts have held that Bitcoin is virtual property. The Chinese central bank's digital currency insists on a centralized management approach, which has a certain fit with the current regulatory policy. In this regard, it is still necessary to clarify the legal status of digital currencies as currencies in the first place. Given this, it is necessary to amend the relevant legal provisions to clarify the status of digital currencies issued by the Central Bank of China, stipulating that the Central Bank's digital currencies have monetary functions and that no subject within the territory may refuse to use them for any reason. Secondly, to expand the international circulation function, the native cross-border payment advantages of digital currency should be used as a key tool in the general context of internationalization. In particular, the current Belt and Road opportunity to expand international circulation permits and promote the digital currency cross-border payment system can be legalized in other countries. "Third, the legal validity of netting and the legal status of settlement finality should be established. From the current technical conditions, the hybrid system integrates the timeliness of the real-time settlement system and the effectiveness of the delayed settlement system in terms of liquidity usage, so it is necessary to clarify the legal validity of netting and gradually establish a bilateral or multilateral netting system." [13]

3.3 Building systematic regulation of cross-border payment regulations

China has certain problems of inadequate application of laws in the field of regulating cross-border payments, such as only partial application of regulatory regulations by the regulated institutions, low level of regulatory documents, and lack of overall planning of legal provisions; the current regulation mainly relies on the Non-Financial Management Measures which are normative documents and should build a basic legal system and raise the level of legislation. Based on the regulatory experience of implementing the Non-Financial Management Measures for 10 years and the Foreign Exchange Guidance issued in 2019, a special chapter on cross-border third-party payment rules should be constructed based on the establishment of the non-financial status of third-party payments, covering specific definitions, regulatory principles, regulatory subjects as well as technical requirements. Based on the hierarchy of the law, there is a greater need to build a systematic cross-border payment regulation, which is primarily in line with Chinese and international factors. The establishment of Chinese law can draw on the US Uniform Virtual Currency Regulation Act, which also has merit as a functional regulatory approach, including specific rules on the definition and scope of virtual currency and the responsibilities and rights of cross-border payment transaction subjects and relevant regulatory subjects. In the design, limited administrative regulations and normative documents can still be continued to be piloted and then rolled out, especially for the current problem that consumers are not protected by the Financial Consumer Protection Law as third-party payments and private digital currencies are non-financial products and virtual property, and specific interface issues should be considered from the top. In terms of internationalization, due to the two-tier operational nature of the central bank's digital currency, it is recommended that access conditions be established to facilitate the participation of international financial institutions in the future.

4. Conclusions

Current Chinese academics study digital currencies and third-party payments separately. This ignores the fact that in practice, the two are included in the relationship and together they form China's cross-border payment system. As a result, through the global perspective of cross-border payments, it can be analyzed that the main problem at present is that the regulatory body causes loopholes in the application of the regulation, presenting the qualities of an overly simple regulatory model and a lack of specificity in the regulatory basis, further hindering the development of an innovative payment system. To this end, it is important to draw on the more mature international regulatory system, to clarify the value logic of the regulatory system currently constructed in China, to clarify the regulatory system that corresponds to responsibilities and rights, and to break through the current academic research that separates the study of digital currencies and third-party payments in the cross-border payment system. It will also help to re-organize the relationship between private and central bank digital currencies, build a regulatory top-level design covering the current mainstream cross-border payment system, and create a balanced situation between benign regulation of cross-border payments and the prosperous development of the cross-border payment industry.

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