

Research on the Impact of Centralized Management of Customer Reserves on Third Party Payment Institutions under Strict Supervision

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ABSTRACT. *In recent years, with the rapid rise of the third-party payment industry in China, the incidents of illegal misappropriation of customer's reserve funds, money laundering and cash arbitrage have occurred frequently. This has caused chaos in financial markets. Based on the analysis of the current supervision system of the third-party payment industry and its drawbacks, this paper explores the impact of centralized deposit of reserve on the third-party payment institutions. Finally, it puts forward relevant policy suggestions for the sustainable development of enterprises from the aspects of strengthening product and service innovation, developing cross-border payment and improving credit rating.*

KEYWORDS: *Third party payment, Customer reserve payment, Strict supervision, Sustainable development*

1. Literature review

In recent years, under the impetus of the "Internet +" innovative economic thinking, Internet finance has seen blowout development, and the volume size has increased rapidly. However, the impact of the third party payment on the traditional financial market has become increasingly apparent. Yu Hongkai (2013) [8] mainly explains the impact and impact of Internet Finance on traditional bank monetary policy and consumer rights and interests, and puts forward feasible countermeasures. Zhang Wenqing and Li Mingxuan (2015) [9] took the deposited funds and electronic currency in the third-party payment transaction as the object, and from the perspective of money supply and demand, the research proved that Internet finance had a profound impact on traditional monetary policy. With the increasing supervision, how to achieve sustainable development of third-party payment institutions has become an important topic worthy of study. Su Pan (2017) [10], Liu Yi (2018) [11], Sun Ruohan (2018) [12] and others point out from

the point of view of customer reserves that China's supervision system for third-party payment platforms is not perfect, there are problems such as misappropriation of customer reserves by institutions, too narrow extension of reserve and unclear ownership of funds fruits, which lead to the enlargement of potential financial risks, and propose targeted regulatory improvement paths. Therefore, based on the current background of strict financial supervision in China, it has profound theoretical and practical significance to explore innovatively the impact of centralized management of customer reserves on the sustainable development of third-party payment platform.

2. Regulation system and disadvantage of third party payment industry

For a long time, the relatively relaxed regulatory environment has made the scale of deposited funds outside the regulatory system larger and larger. Consequently, problems such as multi-account opening, over-range operation, and unclear ownership of currency, low transparency of information and low technical level of Payment institutions are gradually exposed. Once a systemic risk event occurs, it is likely to lead to chaos and collapse of the entire financial industry. Due to the vigorous development of the third-party payment industry, how to strictly supervise the huge amount of customer reserves has always been one of the key tasks of the central bank in preventing and controlling financial risks and maintaining market stability. However, due to the limitation of the scope and intensity of supervision, there are still some obvious drawbacks and omissions.

2.1 Supervision system

At present, the supervision system of third-party payment in China takes the People's Bank of China as the main body of supervision, and the "Measures for the Management of Payment Services of Non-financial Institutions" and "Measures for the Customer Reserve Deposit of Payment Institutions" as the programmatic documents. With a series of detailed documents (see Table 1), it has formed the basic regulatory system of the central bank's macro-guidance and supervision, industry self-regulation, external supervision of commercial banks and internal self-management of institutions. This is of great significance and role in avoiding systemic risks, maintaining market stability and promoting the healthy and sustainable development of third-party payment institutions.

Table 1 Supervision System of Third Party Payment of Central Bank

Time	Regulatory documents
January 1999	<i>Notice on the Strictness of Deducting Reserve Deposits of Financial Institutions for Payment of Deposits of Other Financial Institutions</i>
June 2010	<i>Measures for the Administration of Payment Services of Non-financial Institutions</i>
November 2011	<i>Interim Measures for Customer Reserves Deposit of Payment Institutions (Draft for Consultation)</i>
July 2012	<i>Notice on the Establishment of a Regulatory Reporting System for Payment Institutions</i>
September 2012	<i>Measures for the Management of Advance Card Business of Payment Institutions</i>
June 2013	<i>Measures for Customer Reserves Deposit of Payment Institutions (hereinafter referred to as the Measures)</i>
April 2014	<i>Circular of the People's Bank of China Banking Regulatory Commission of the People's Bank of China on Strengthening the Management of Cooperative Business between Commercial Banks and Third Party Payment Institutions</i>
December 2015	<i>Measures for the Management of Network Payment Business of Non-Bank Payment Institutions</i>
October 2016	<i>Circular of the People's Bank of China on Strengthening the Management of Payment and Settlement and Preventing New Illegalities and Crimes in Telecom Networks</i>
January 2017	<i>Notice of the General Office of the State Council on Issuing the Implementation Plan for the Special Regulation of Internet Financial Risks</i>
August 2017	<i>Notice of the Payment and Settlement Department of the People's Bank of China on the Transfer of Network Payment Business of Non-Bank Payment Institutions from Direct-link Mode to Online-link Platform for Processing</i>
July 2018	<i>Notice of the General Office of the People's Bank of China on Implementing Concentrated Deposit of Customer Reserves of Payment Institutions</i>

2.2 Disadvantages of the regulatory system

(1) The multi-opening of reserve accounts results in the difficulty of decentralized deposit and supervision of reserves. According to the provisions of the *Measures*, third-party payment institutions shall not open reserve accounts in more than five banks to ensure the safety of funds. In fact, there are often dozens or even hundreds of reserve accounts opened by payment institutions, the reserves are dispersed and deposited, and the banks have frequent contacts with third-party payment institutions. In the field of the third party payment, Alipay and Tenpay play a leading role. Alipay once appeared "a bank connecting two hundred customer payment accounts". In addition to increasing the difficulty of enterprise self-management, it also gives some misguided Payment institutions the opportunity of illegal financing. There may even be collusion between non-bank institutions and banks to escape supervision, which brings great difficulties to the supervision of relevant departments.

(2) Payment institutions adopt the "direct connection" mode of agency liquidation, and operate beyond the scope, which hinders financial supervision. The so-called "direct connection mode" refers to the third-party payment institutions in their daily business operations bypassing the state's statutory independent liquidation

institutions, and then directly open accounts with banks, transfer funds or deposits and withdrawals. They use many reserve accounts to replace the liquidation function. This model makes payment institutions often drift away from bank supervision, and the information transparency is low. According to the balance sheet of the Central Bank, the balance of deposit accounts of non-financial institutions (customer reserve) was 84.077 billion yuan in June 2017, and reached 124 trillion yuan by November 2018, an increase of nearly 14 times. As a result, more and more third-party payment institutions deviate from the intermediary service function of collection and payment on behalf of the growth of the size of deposit funds. They take the place of depository banks to handle cross-bank receipts and payments, illegally misappropriate the reserve funds to earn interest income, and there is a phenomenon of over-range operation. This will easily lead to risk exposures and systemic risk events.

(3) The content of supervision is vague and the ownership of interest income of reserve fund is unclear. The reserve fund originally refers to the excess reserve deposited by commercial banks in addition to the statutory deposit reserve of the central bank for daily expenses. Later, due to the emergence of third-party payments, the reserve fund also includes deposits of similar banking institutions. According to the *Measures*, the relationship between the client and the payment institution is a contractual relationship, that is, the third party payment institution can only temporarily replace the customer management fund, and the ownership of the fund is still attributable to the customers. The interest on the reserve payment should also be enjoyed by the customers according to the law. But in reality, it is the payment institutions that rely on this huge interest to seek development, which reflects the imperfection of our country's capital deposit control system. In addition, it is not difficult to find that the central bank has no clear regulation on the content of supervision. As a result, local branches are ambiguous in implementing relevant resolutions, and the effectiveness of supervision naturally declines.

(4) The risk prevention and control system of Payment institutions is not perfect and the technical standards are low. According to the latest data from the Central Bank, there are 271 companies with third-party payment licence in China. The first company to be approved was Alipay, UnionPay in 2013. As of 2018, Alipay has become the world's leading mobile payment company with a market share of 55.40%. However, it is worth noting that there are still many companies with payment business license, but the organizational structure is not perfect, the internal monitoring system and risk management system are not perfect, and the technical standards are not up to the standard. Due to the increasingly fierce market competition, these companies tend to ignore customer capital security and industry stability, and only seek to maximize the company's short-term interests, which are difficult for regulatory authorities to touch and change. Secondly, in the process of issuing financial licences, it relies on declaration and related filing. Supervision is often passive, and a complete monitoring system has not yet been established for the deposit of institutional customers.

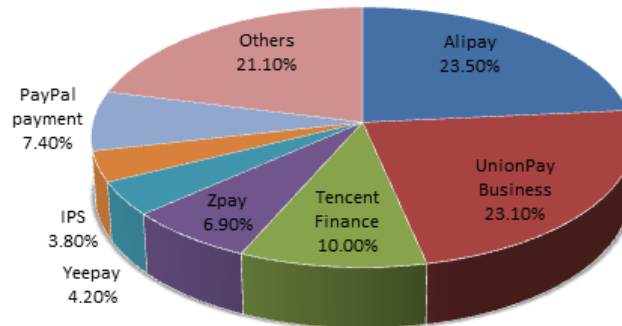


Figure. 1 Distribution of Transaction Volume in China's Internet Payment Market in 2018

3. The Impact of Centralized Customer Reserves on Third Party Payment Institutions

(1) To narrow the profit channels and limit the expansion of enterprises. Centralized deposit of customer reserves is a new challenge, even a fatal blow, for small and medium-sized Payment institutions which rely solely on interest income as the main source of profit. For Alipay, Tencent finance and other similar large third party payment institutions, the centralized payment of the reserve fund has deprived the organization of an important business profit channel. If it does not adjust the income structure in time, it will impede the merger and reorganization and investment expansion of the enterprise.

(2) It is conducive to standardizing and improving the liquidity management of enterprises, improving the service efficiency of institutions and the level of risk prevention and control. At present, the situation of multi-account opening of reserve fund exists in the third-party payment institutions, which leads to frequent and complex capital exchanges between Payment institutions and commercial banks. In addition to bringing regulatory blind spots, the decentralized management of large amounts of funds will increase the cost of enterprise services. The centralized deposit management of the reserve fund will effectively play the role of "breaking the direct connection". Once the reserve funds are allocated and cleared by the central bank, it will help to improve the liquidity management of funds and improve the efficiency of payment services in an all-round way.

(3) It is helpful to clear the market, promote the innovation and development of enterprises, and enhance the core competitiveness. Due to the huge "temptation" of Reserve interest income, the market participants are increasing day by day, and the industry competition is becoming more and fiercer. The homogenization of products and services makes the development of the industry stagnant. The centralized deposit of customer reserves will pull all third-party payment institutions to the same starting line. Under the same conditions of infrastructure, tariff standards and

policies, enterprises can only rely on the innovation and diversification of products and services to increase innovation revenue and occupy more market share. This will play a great role in accelerating product innovation, service innovation and management innovation.

(4) It will help to rectify financial chaos and maintain financial market order. In 2018, the Central Financial Working Conference put prevention and resolution of major financial risks at the top of the three major battles. It fully reflects the worrying consciousness and bottom line thinking of the CPC Central Committee and the State Council "putting risk prevention and control in a more prominent position". The central bank gradually increases the deposit ratio of reserve funds, which plays an important role in clarifying the functions of third-party payment institutions and commercial banks and cutting off the unfair interest transmission between them. The centralized deposit management of reserve fund will promote Payment institutions to return to the convenient and slight main business of payment and seek practical innovation. At the same time, it demonstrates the central government's determination to crack down on financial market violations and crimes, which is conducive to strengthening supervision and promoting the healthy and stable development of the market to establish a more efficient financial service system.

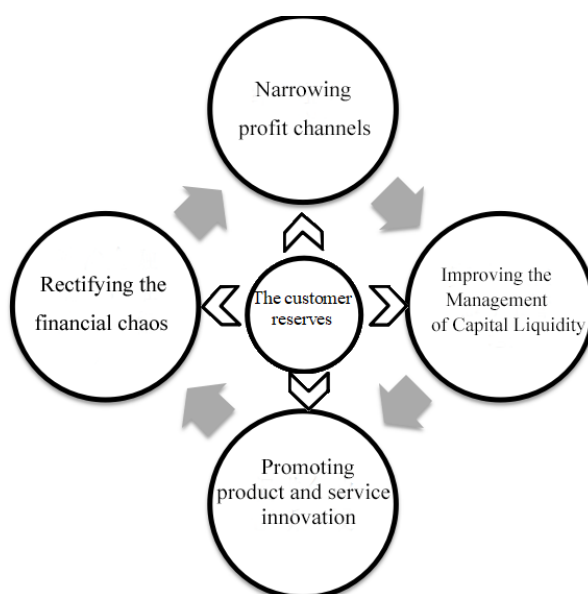


Figure. 2 Impact of centralized customer reserves on third party payment Institutions

4. Suggestions on Sustainable Development of Third Party Payment Institutions

4.1 Strengthen the construction of technology and internal control

Third-party Payment institutions use the Internet to carry out various payment services, which require higher security of enterprise technology level, software and hardware systems, infrastructure and so on, but still do not rule out the possibility of technical risks. Therefore, enterprises should first strengthen technological construction, vigorously develop and import high-tech safety tools, and improve the technical indicators monitoring system. Then establish a complete and reliable system operation procedures to effectively protect the user's funds and payment security. Secondly, enterprises should also pay attention to the establishment of strict internal control system and separate incompatible posts in accordance with the "Accounting Standards for Enterprises". Enterprises should also improve their organizational management system, internal supervision and review system, and operate in accordance with rules and laws.

4.2 Strengthen technology and service innovation

Innovation is undoubtedly an important driving force for third-party payment institutions in the 21st century, when the scientific and technological revolution sweeps the globe. Under the background of strict financial supervision, third-party institutions need to accelerate the transformation and upgrading of enterprises in order to achieve considerable development. They should start from the needs of consumers, improve the level of product innovation and service innovation, and bring more efficient services and safer protection to customers. For some small and medium-sized Payment institutions with weak strength, the centralized deposit of reserve fund actually provides them with an opportunity for further development. By creating a fair competitive environment, encouraging them to actively reform and innovate, they can achieve stable status and development in the stern third-party payment industry.

4.3 Develop overseas markets and promote cross-border payment

With the implementation and promotion of the the Belt and Road Initiative in China, the demand for cross-border payment brought by goods exports is very rapid. The proportion of exports from 2014 to 2018 has increased year by year. What's more, the improvement of people's living standards has made the number of outbound tourists and international students grow rapidly: 131 million in 2017 and 608.4 million in 2018, respectively. As a result, more demand for cross-border payment has emerged, and the overseas payment market has great potential for development. Under the market saturation of the C terminal market, the development of B terminal and overseas payment market has become a new development direction of Alipay, Tenpay and other industry giants as well as small and medium-sized Payment institutions.

4.4 Improve the compensation mechanism and improve the credit level

Credit rating is undoubtedly the decisive factor for third-party payment institutions to develop the C-terminal personal payment market, and the core lifeline for the survival and development of enterprises. Nowadays, with the frequent revocation of licenses caused by misappropriation of reserve funds and illegal money laundering, Payment institutions should actively introduce third-party credit rating agencies to improve their own credit rating while establishing customer credit rating monitoring mechanism, improving credit information management system and improving the level of credit between buyers and sellers. In addition, when disputes arise between the two sides of the transaction, the payment institution should start the compensation mechanism in time to settle disputes quickly. Enterprises should provide users with a safe payment environment and a good user experience, in order to seek longer-term development of enterprises.

5. Conclusion

Customer reserves of third-party payment institution is the fund that the customer temporarily transfers to the payment institution for custody before completing the transaction with the merchant, and the customer enjoys ownership. For a long time, China's loose regulatory environment has led to the third-party payment institutions to open multiple accounts and earn huge interest from the reserve fund, resulting in the instability of the financial market. This time, the central bank requires payment institutions to deposit 100% of the customer reserves to the central bank, which is of great significance to rectify the financial market, maintain market order and strengthen financial supervision. At the same time, it also puts forward higher requirements and greater challenges for payment institutions. Under the environment of increasing supervision, it is still a long way to go for third-party payment institutions to achieve sustainable development through transformation and upgrading.

Acknowledgments

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