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International Experience and Reference of China's Financial Regulatory System Reform

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Abstract: Since the 1970s, in order to reduce financial risks in the context of fast-paced growing financial industry, China has been implementing reforms to its financial regulatory structure. In 2023, the State Administration for Financial Supervision and Administration was officially established, bringing China closer to mixed industry regulation. Currently, there are multiple types of financial regulation on a global scale, including segmented regulation, single regulation, functional regulation, and bimodal regulation. Given the rapid development of China's financial market, it is imperative to draw on better international expertise, innovate domestic regulatory framework, and persist pursuing bimodal regulatory mode under the mixed industry background. By implementing the bimodal regulation of macro prudential regulation and micro behavioral regulation, China is managing to control financial risks, protect investors' lawful rights and interests, and foster the long-term and stable expansion of China's financial industry.

Keywords: Financial regulatory system, Reform, International experience, China

1. Introduction

The primary objective of financial regulation is to prevent and address financial risks, particularly those that have the potential to impact the whole financial market. The financial regulatory system is a government mechanism that adapts to change risks within the financial market, addressing systemic financial risks associated with businesses, products, and behaviors.

In the 1970s, China's initial financial regulatory system was a unified regulatory system. In addition to being in charge of developing monetary policy, the People's Bank of China was also responsible for regulating the banking, insurance, securities, and trust industries. Since the 1990s, China has gradually formed a separate financial regulatory system consisting of one bank and three committees. The supervision of various parts of the financial industry, including the monetary market, trust institutions, and anti-money laundering initiatives, is the primary duty of the People's Bank of China. The chief duty of the "three committees" is to develop regulatory regulations as well as normative documents, and to closely supervise associated industries through company evaluations, on-site inspections, and other methods. After 2017, in order to effectively strengthen financial supervision, resolve financial risks, China began to further adjust its financial regulatory system, resulting in establishing the Financial Stability and Development Committee.The China Insurance Regulatory Commission and the China Banking and Insurance Regulatory Commission unified in

2018, setting up the China Banking and Insurance Regulatory Commission, which further improved China's financial regulatory system. This signifies that China's financial regulatory system has progressed to a new era led by the Financial Stability and Development Commission, the People's Bank of China, the China Banking and Insurance Regulatory Commission, and the China Securities Regulatory Commission, marking that the comprehensive regulatory cycle has officially commenced. In 2023, the China Banking and Insurance Regulatory Commission officially changed its name to the State Administration of Financial Supervision and Administration, and the functions of the State Administration of Financial Supervision and Administration and the China Securities Regulatory Commission (CSRC) were further coordinated. The investor protection responsibilities of the CSRC were transferred to the State Administration of Financial Supervision and Administration, and comprehensive supervision was further advanced [1].

As the global economic and financial risks continue to increase, and modern technology bringing enormous changes to the financial industry, there is an urgent need to deepen the reform of the financial regulatory system for financial regulation, including constantly modify and adapt to the requirements of both domestic and international financial progress, as well as prevent and resolve financial hazards. China's financial regulatory structure will undergo further reform in the future. This article examines China's financial regulatory system and offers practical proposals for the reform of it.

2. Types of International Financial Regulatory Systems

2.1. Functional Regulation

Functional regulation establishes distinct regulatory divisions according to the functional characteristics of financial activities and enforces regulations based on the inherent nature of financial businesses and products.The defining characteristic is that regulation focuses on things rather than individuals, allowing for market, cross-product, and institutional oversight of the financial sector[2]. The essence of functional regulation remains separate supervision, which serves as a supplement to the model's shortcomings. While the latter is split by the identity and characteristics of financial institutions, the former is divided by the functional characteristics of the financial industry.

Functional regulation and segmented regulation both originated in the United States. After the Great Economic Crisis in 1929, the United States artificially divided and operated the banking, securities, and insurance industries, and adopted segmented regulation led by institutions such as the Federal Reserve, Securities and Exchange Commission, and Commodity Futures Trading Commission. In the 1980s, financial liberalisation in the United States challenged the traditional financial service market structure, blurring the boundaries between the banking, securities, and insurance businesses. To avert challenges to established regulatory models, the Gramm Law introduced functional regulation as an additional regulatory system, which substantially addressed the deficiencies of the initial segmented regulation in terms of the lack of consistency and continuity.

2.2. Integrated Regulation

Integrated regulation is mainly carried out by a financial regulatory agency within a country, which is responsible for all regulatory work in the financial market. Countries that adopt this model mostly establish central banks to promote it. By establishing a single financial regulatory department and unifying the oversight of the entire financial industry, boundary issues within the financial sector become unnecessary concerns and comprehensive industry oversight can be attained. This adapts to the situation of various business formats being intertwined under modern mixed operation, and is an intuitive reflection of the increasingly blurred trend of the financial industry boundary [2].

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UK was the first to implement single regulatory model, followed by countries such as Germany, South Korea, Japan, and Singapore. As early as 2000, UK merged banking, insurance, and securities industries and established the Financial Services Authority (FSA) to regulate almost all financial industries. The FSA implements undifferentiated supervision for risk management of financial institutions, and coordinate with external forces such as registered accountants to regulate financial institutions with higher risks. This approach offers the advantages of low cost and high consistency, but it is difficult to govern due to variances within industries and is prone to regulatory monopolies.

2.3. Bimodal Regulation

"Twin peak" of bimodal regulation refers to behavioral regulation and prudent regulation, respectively. "Behavioral regulation" represents the regulation of marketing activities concerning financial products and services, the supervision of speculative business activities, and the protection of financial consumers and investors. On the other hand, prudential regulation entails the prevention and control of risks by regulatory financial institutions, as well as the maintenance of financial market security and stability. Bimodal regulation is also referred to as "target regulation" since it can accomplish the objectives of safeguarding financial consumers and averting financial institution bankruptcy.

Australia first adopted this model in 1997, establishing the Australian Securities and Investments Commission and the Australian Prudential Regulatory Authority, which respectively regulates financial trading behavior and the safety of financial institutions and the overall financial system. As the central bank, the Reserve Bank of Australia is only responsible for monetary policy and overall financial security and does not assume regulatory functions for individual financial institutions. Australia has thus formed a "dual peak regulatory" model known as the "triple structure"[2]. This model effectively reduces conflicts and overlaps between regulatory agencies, and improves the systematic and collaborative nature of regulation. Integrating financial market regulation and monetary policy at the same time ensures financial market stability and successful monetary policy implementation.

3. The Historical Process and Current Situation of China's Financial Regulatory System

3.1. The Historical Process Of China's Financial Regulatory System

Since the reform and opening up in the 1980s, the size of the China’s financial market has grown, financial institutions have continued to increase, and financial business has undergone earth shaking changes. The development of China's financial regulatory system is progressing and can be classified into four stages based on the time frame.

The first stage was from 1949 to 1978, due to the absence of a comprehensive financial regulatory structure during the planned economy era, the People's Bank of China took responsibility for all financial transactions.

The second stage focused on 1978-1992, when the financial industry resumed development and the financial regulatory system was initially established. The People's Bank of China had the dual responsibility of devising monetary policy and overseeing financial institutions across the nation [3]. Under the direction of the State Council, the state organ was in charge of coordinating the management of the country's financial matters. Administrative measures were frequently utilized to carry out regulatory responsibilities, and related laws and regulations had only a minor regulatory role in financial regulation.

The third stage was from 1992 to 2003, with the rapid development of various financial sub industries and the gradual formation of a separate regulatory pattern. The financial regulatory system shifted from unified regulation by the People's Bank of China to separate supervision of the banking, securities, and insurance industries, forming a regulatory model of "one bank, three meetings"[4].

Initiated after 2003, the fourth phase seeks to enhance regulatory coordination through the integration of financial operations. The financial regulatory system is transiting towards a more encompassing kind of oversight. Focusing on predicting international financial risks, in order to systematically carry out risk prevention, and provide guidance and supervision for financial development across the country, 2018 saw the merger of the China Banking Regulatory Commission and China Insurance Regulatory Commission, creating a new regulatory framework.

In March 2023, China's new round of financial regulatory system reform clearly emphasized the need to strengthen centralized, unified, and fully covered supervision. Instead of keeping China Banking and Insurance Regulatory Commission, the State Administration for Financial Supervision and Administration will be constructed and take over it. Besides, the new institution will take on the daily regulatory obligations concerning financial holding companies and other financial groups of the People's Bank of China, as well as the responsibility for financial consumer protection duties about investor protection of the China Securities Regulatory Commission. The China Securities Regulatory Commission continues to maintain its functions, while certain responsibilities have been transferred and reorganized by the State Council.

3.2. Current Situation of China's Financial Regulatory System

There have been considerable shifts in the field of finance in the last several years, with the trend of financial innovation, Internet finance, and financial liberalization becoming increasingly evident. More and more cross industry and cross market financial institutions, businesses, and products have emerged, posing a certain degree of challenge to the existing financial regulatory system.

Regulation lags behind financial innovation. For example, the business model of Internet finance cannot be covered by current regulatory legislation. It is difficult to grasp the regulatory strength of financial innovation products, and the restrictions are too large to fully leverage the advantages of Internet finance, leaving a large space for timely grasping the financial risks arising from its unrestricted development. The regulatory bodies' scope has significantly expanded beyond its conventional boundaries, as the environment and scope of Internet finance continue to evolve [5].

Financial customers are not well protected. China has not yet established an independent financial consumer protection agency; The increasingly diverse financial investment and consumption sectors, as well as the relatively weak risk prevention and control awareness among the public, make financial investors and consumers vulnerable to financial fraud. The limited degree of information disclosure regarding relevant financial products and the limited remedies available for consumers when their legitimate rights and interests are infringed upon make it difficult to effectively protect property safety, and it is also not conducive to the development of future investment activities.

In 2023, a new round of financial regulatory system reform implements, establishing the State Administration for Financial Supervision and Administration, as well as the redistributing regulatory responsibilities for relevant financial groups, consumer rights protection, and investor rights protection. The Chinese financial regulatory system is also constantly drawing on international experience, combining with its own national conditions, innovating models, and accelerating the transition from separate supervision to mixed supervision, which mainly reflected in the following four aspects:

Firstly, horizontal organizational reform is being implemented [6]. The main manifestation is the establishment of the State Administration for Financial Regulation based on the former China Banking and Insurance Regulatory Commission, which integrates the supervision of the financial industry outside of the securities industry into a unified regulatory system.

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Secondly, vertical organizational reform is in progress [6]. In order to implement "central direct management" in the financial sector, local financial regulatory system comprised primarily of locally delegated agencies of the central financial management department is established [6]. The central government collects financial power and coordinates the top-level design of promoting financial stability and development; Local financial regulatory agencies are responsible for regulatory duties. This contributes to resolving the conflict between "regulation" and "development" between central and local governments, as well as separating the functions of financial regulation and financial development [7].

Finally,the bimodal regulation is further strengthened.On the one hand, distinguish macroeconomic regulation and financial regulation, transfer the institutional regulatory functions of the People's Bank of China to the State Administration of Financial Supervision, so that the former can focus more on tackling key issues and prudential regulation, while the latter can timely undertake relevant work and achieve comprehensive implementation of prudential regulation. On the other hand, enhance behavioral control in the financial sector. The State Administration of Financial Supervision will take over the People's Bank of China's responsibility for consumer protection and the China Securities Regulatory Commission's responsibility for investor protection[8].

4. Suggestions for Improving China's Financial Regulatory System

4.1. Implement The Dual Peak Mode

The long-term goal of financial regulatory system reform should be setting up the bimodal regulation. In the future, the China Securities Regulatory Commission and the State Administration for Market Regulation could be combined. The People's Bank of China would be in charge of macroprudential management, and the State Administration for Market Regulation would be in charge of micro-behavioral supervision, jointly protecting investors' legitimate rights and interests [2].

Dual peak regulation includes three pillars: macro prudential, micro prudential, and behavioral regulatory. The law should provide effective protection for these three pillars. The new legal framework needs to define the basic legal system of the three pillars, including their connotation boundaries, responsible parties, functional authorities, and coordination and cooperation arrangements. Clarifying the authorities that the Central Financial Commission possesses in order to coordinate the activities of the various financial regulatory agencies is required.; The People's Bank of China is responsible for macro prudential regulation and regulating monetary policy; The State Administration for Financial Regulation is responsible for improving the micro prudential regulation system, strengthening the supervision and law enforcement of market wide behavior, and protecting the legitimate rights and interests of investors and financial consumers[9].

4.2. Enhance Financial Regulatory Capabilities

One is to vastly enhance the quality of financial regulation. Financial regulation has the characteristics below: widely extending supervising scope, which includes non-financial fields; and the scope of financial regulation extends widely, involving many non-financial fields; precise risk controlling targets; collaboration among multiple departments in execution process [10]. In response to these features, it is necessary to establish an inspection bureau and the inspection team to respond quickly, act flexibly, and establish a joint law enforcement mechanism with public security, disciplinary inspection and other departments. Greater emphasis should be placed on the vital aspects of specific actions, necessitating a shift in work approach from previous emphasis on the financial operations of multiple organizations to a focus on these crucial elements. This entails addressing the important individuals, key issues, and key behaviors [11].

Another approach is to enhance pre-risk preventative measures. Preventing financial hazards from arising is the key to resolving them effectively. The mindset of adopting a "reactive approach to risk management after the fact" must be promptly converted to a "proactive strategy for risk prevention prior to and during the occurrence." The vertical financial reform trend should be put into practice, along with the ideas of "one bank, one policy" and "one province, one policy," accurate policy classification and implementation, prompt risk prevention and control, and risk orientation. The horizontal financial reform trend should be followed, risk-oriented, and directly investigate and handle sensitive, complex, and significant financial security incidents, or assign them to remote institutions to handle quickly. To identify financial risks, we should not merely rely on normal regulatory activity [12].

4.3. Enhance The Safeguarding of Financial Customers

It is of great importance to hasten the development of consumer-protecting work pattern, enhance coordination mechanisms to safeguard financial consumers' rights, provide multiple avenues for resolving consumer disputes, and push for the establishment of a consumer protection work system that is transparent, effective, and easy to use [13]. Establish a sound system for disclosing financial product information, promote financial institutions to conduct customer risk preference assessments, crack down on false advertising and misleading sales, and effectively protect the right to know and choose financial consumption, facilitating the protection and relief of the financial consumers' interests [14]. Establishing unified identification standards and screening methods for "effective complaints" can guarantee that reasonable consumers' demands are promptly responded to and properly resolved. Financial consumers should also actively learn and receive relevant publicity and education and strive to improve their personal finance in modern society [15].

5. Conclusion

The existing international financial regulatory methods, whether functional regulation, single regulation, or bimodal regulation, have their unique financial market backgrounds and national policy environments. In the rapid developing financial market of China, new digital financial products are constantly emerging, with more and more investors joining the related activities [16]. The relevant departments have made efforts to establish the State Administration for Financial Regulation, deepen horizontal organizational reform, establish a system for local financial supervision that is mostly comprised of agencies sent out by central financial management department, promote vertical organizational reform, and coordinate measures for behavioral and prudent supervision. However, to maintain the stable development of the nation's finance, it is still necessary to follow market development, learn from advanced foreign experiences, while fully considering local conditions, and gradually reforming China's financial regulatory system,in order to implement the bimodal regulatory model, enhance financial regulatory capabilities, and protect financial consumers in China.

At present, China's economy is in a period of climbing and overcoming obstacles, with various problems in financial sector intertwining and influencing each other, some of which are still prominent. There are still many economic and financial risks and latent dangers, and the quality and efficiency of financial services for the real economy are not high. Financial chaos and corruption continue to persist, and financial regulatory and governance capabilities are still weak. Under the task of building a strong financial country, China's financial supervision must be strengthened to effectively resolve the risks and promote high-quality economic development.

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