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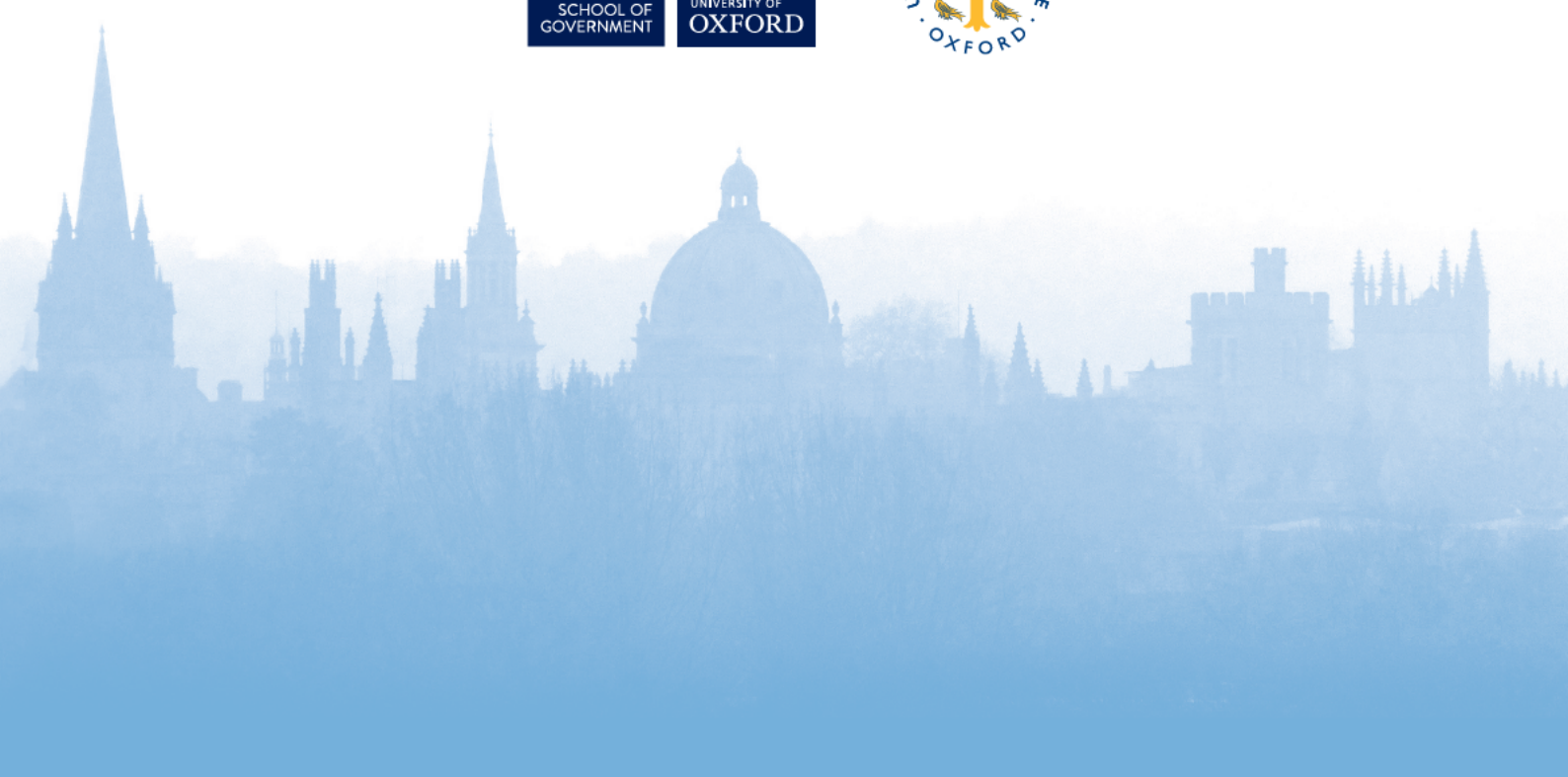
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From shadow banking to digital financial inclusion: Regulatory framework contestation between China and the FSB

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Abstract

China's involvement in global financial regulatory governance in the wake of the global financial crisis has surprised many observers. While Beijing has pushed for governance reform in the international financial institutions and created alternative ones, Chinese representatives in the Financial Stability Board and the standard-setting bodies it coordinates have adopted a comparably passive stance. This paper however identifies recent signs of discontinuity in China's accepting embrace of global financial standards. While policymakers supported the interpretation of non-bank financial services as "shadow banking" early on, they are challenging this frame half a decade later. Global regulatory bodies are reluctant to adjust the frame of shadow banking in order to incorporate developing country preferences. In response, Chinese authorities are redefining the label of its fast-growing non-bank financial sector to imbue it with regulatory legitimacy. They have promoted a shift away from shadow banking to the overlapping frames of fintech (internet finance) and financial inclusion. The interaction between Chinese and international regulators reveals the options and constraints the rising power faces in the political economy of global financial regulatory governance.

Key Words

financial regulation, government networks, China, shadow banking, financial inclusion

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Introduction

Global financial regulation has been the exclusive terrain of advanced economies for decades. Until recently, all representatives at the table of standard-setting bodies (SSB) hailed from industrialized countries, and the regulatory standards and best practices they promoted were conceived only with member jurisdictions in mind. Nevertheless, global standards are adopted by a much wider range of countries who have had no opportunity to participate in their development. The incongruities between financial sector assumptions of global SSB and the structural economic realities of developing countries raise important questions regarding the viability of a one-standard-fit-all approach to financial regulation (Jones 2014; Jones and Knaack 2017).

In the wake of the global financial crisis, all developing country members of the G20 were invited to join global SSB. But even though emerging market representatives now formally take part in regulatory negotiations, there is little evidence that the new members have pushed SSB to pay more attention to development prerogatives. Only recently we find emerging signs of contestation within the Financial Stability Board (FSB), the G20's handmaiden in global financial regulatory reform.

This paper analyzes China's involvement in a key diplomatic struggle in the Financial Stability Board over the regulatory approach to non-bank financial intermediaries (NBFI) worldwide. The spectrum of NBFI ranges from mobile banking providers and payday lenders to broker-dealers and hedge funds. In the wake of the global financial crisis, the G20 authorized the FSB to develop a comprehensive regulatory approach to this wide array of financial services under the label of "shadow banking".

Regulators from advanced economies took the lead in defining shadow banking chiefly as a potential source of systemic risk that deserves close monitoring and control. In recent years, emerging market economies in the FSB have contested this frame arguing that NBFI also serve important financial development needs. Beijing in particular has forged an alliance with other Asian regulators to promote a regulatory approach to NBFI that strikes a balance between promotion and risk control.

Yet there is no evidence that FSB policy work has incorporated such development prerogatives to date. In the face of FSB recalcitrance, we see the emergence of two policy responses aimed at preserving regulatory autonomy in China. First, Chinese regulatory authorities have sharply limited their degree of cooperation with the FSB in the field of shadow banking, sharing only a modicum of financial data with their peers. Second, Beijing has engaged in a strategic frame shift, promoting NBFI under the overlapping labels of financial inclusion and financial technology (fintech). This paper maps Chinese NBFI to show that the dividing lines between financial inclusion, fintech, and shadow banking are blurry and contested. Domestically, this situation provides traditional shadow banking actors with an incentive to engage in window dressing as fintech companies. Internationally, it sets the scene of contestation between financial supervisors from China, other emerging economies, and advanced countries of how to understand and regulate NBFI.

This paper provides a novel attempt at analyzing the political economy of financial regulatory struggles and negotiations between China as a leading emerging market economy and global standard-setting bodies. Applying frame analysis to regulation of non-bank financial services, it highlights the contingency of policymaking space on stakeholders and their frames at the intersection of financial regulation and development.

The remainder of this paper starts with an assessment of China's role in global financial governance in general and SSB in particular. It lays out the theoretical foundations for frame analysis in international society and applies it to trace the development of two alternative frames for NBFI at the international stage, namely shadow banking and financial inclusion. The following sections then analyze the evolution of China's shadow banking sector and Beijing's unsuccessful attempt to modify the shadow banking frame in the FSB. Subsequently, the paper shows how Chinese authorities reduced cooperation with the FSB and engaged in a strategic frame shift away from shadow banking and towards internet finance (互联网金融). Combined with the financial inclusion frame, this new interpretation of NBFI provides policymakers in China and other developing countries with greater leeway to engage in prudential development of the domestic financial sector. The article concludes with considerations regarding power dynamics in the regulatory bodies of global financial governance.

China's role in global financial governance

China's weight in global financial governance increased significantly in the wake of the global financial crisis. Together with other emerging market economies (EME), China became a formal member of all financial standard-setting bodies and raised its representation in the Financial Stability Board (FSB), the reconstituted government network in charge of coordinating global financial regulatory efforts. Over the last seven years, Chinese regulators have participated in transgovernmental deliberations that led to the issuance of a wide variety of new global financial standards, including on derivatives regulation, bank capital requirements, and ending too-big-to-fail.

Participation however is not synonymous with influence. The literature on the political economy of global regulatory governance identifies two sources of power: market size and expertise. Several scholars have highlighted the leading role of dominant financial centers in standard-setting (Simmons 2001; Oatley and Nabors 1998; Drezner 2007; Singer 2007; Posner 2009). According to this approach, regulators in the jurisdictions that supervise the largest shares of global market actors have the first-mover advantage and the go-it-alone-power to push for a convergence of global standards in line with their preferences.

A second approach to global regulatory power ranks jurisdictions by regulatory capacity and expertise. Advanced economies with a longer track record of supervision and a more complex regulatory architecture are expected to lead global regulatory deliberations, thus wielding significant influence over the standard-setting process (Slaughter 2004; Raustiala 2002; Baker 2009; Tsingou 2010; Farrell and Newman 2010).

As Kempthorne (2016) rightly points out, in the realm of financial regulation China currently commands neither of these sources of power to be considered a leading jurisdiction. The small size and low degree of cross-border interconnectedness of China's financial market stands in stark contrast to its position in the global trade system. And China's financial supervisors have not yet accumulated regulatory experience and capacity equivalent to that of their colleagues from advanced economies (Walter 2016).

Thus, taking constraints in market size and regulatory capacity as well as an inward-looking orientation of regulators into account, it should not come as a surprise that China has wielded little influence in financial regulatory negotiations to date. Moreover, it has agreed to external evaluation under the Financial Sector Assessment Program and a variety of other peer reviews, compromising on its notion of sovereignty and fulfilling global expectations regarding its role as a "responsible stakeholder" in global financial governance (Gottwald and Bersick 2015; Ifeng Finance 2011). Chinese regulators have even moved beyond mere adherence to global standards, issuing domestic banking requirements that are super-equivalent to Basel III (Sekine 2011; Walter 2014; Knaack 2017).

However, there are emerging signs of discontinuity in China's accepting embrace of global financial standards. This article provides an analysis of Beijing's shift in attitude vis-a-vis the dominant global regulatory approach to non-traditional financial services. While policymakers in China supported the interpretation of such services as "shadow banking" in the wake of the crisis, they are challenging this frame half a decade later. Moreover, in the face of reluctance by global regulatory bodies to adjust the frame of shadow banking in order to incorporate developing country preferences, Chinese authorities have reduced international regulatory cooperation and undertaken a strategic frame shift to imbue its fast-growing non-traditional financial sector with regulatory legitimacy. Specifically, they have promoted a shift away from "shadow banking" to the overlapping frames of fintech (internet finance) and financial inclusion as the salient interpretative scheme for non-banking financial services. Before tracing the interaction between domestic authorities and global regulatory bodies

from frame acceptance to frame dispute and eventually frame shift, a look at the existing scholarship on frames in international relations is in order.

Frame analysis in international society

The concept of frames was originally developed by Erving Goffman, a leading social theorist who dedicated most of his career to the sociology of everyday life, the social construction of self, and the organization of experience by means of social interaction. Goffman understands frames as “schemata of interpretation”, heuristics that contribute to the mental and normative organization of a social environment. Frames allow humans to reduce complexity and uncertainty, providing narratives that guide both our understanding of social and natural phenomena and a set of adequate actions in practical situations. Beyond merely comprising of a set of norms, frames are of epistemological quality, serving as lenses through which human experiences are refracted (Goffman 1974; Béland and Cox 2011; Bourdieu and Wacquant 1992).

While Goffman’s work situates frames at the inter-individual level of society, the concept retains its analytical value when applied at another level of aggregation. Nation-states can be understood as entities that insert themselves in a purposive global social order under a set of shared understandings and institutions constituting international society (Bull 1977; Wendt 1999; Buzan 2004). State and non-state actors in this international society develop and negotiate frames to make the international political economy legible and understandable. Building upon this epistemological function, frames also serve as a tool to attribute actions and phenomena to motives, allowing stakeholders to evaluate them against a normative benchmark. Internationally, the source of power of a given frame rests on its claim to universal applicability: particularistic models or local frames attract little attention. Nation-states and other actors thus continuously seek to organize and legitimate themselves in terms of frames that are developed and disputed at the international level (Rein and Schon 1996; Beckert and Streeck 2008; Blyth 2002a; Meyer et al. 1997).

In the realm of financial regulation, representatives from advanced economies have enjoyed unrivaled framing power for decades (Blyth 2002b). Yet first signs of discontinuity are emerging: Chinese officials are engaged in a frame dispute regarding shadow banking. Faced with recalcitrance by dominant stakeholders in global financial governance institutions and minimal success in changing the frame, policymakers in Beijing then resorted to a new strategy. They reduced the extent of cross-border information sharing and promoted a shift away from shadow banking and towards technology-driven financial inclusion as a lens through which to observe the burgeoning domestic non-bank financial sector. This shift was facilitated by the availability of the financial inclusion frame in global financial regulatory institutions and its acceptance among regulators from dominant financial jurisdictions.

The following section traces the establishment of the shadow banking frame and the financial inclusion frame in the G20 and the Financial Stability Board (FSB).

Frame establishment: Shadow banking and financial inclusion in the G20

For the purposes of this paper, two frames regarding non-traditional financial services and their regulation are of primary relevance. These are shadow banking and financial inclusion, and coincidentally, both enter the G20 policy discourse at roughly the same time.

Regulatory efforts immediately after the global financial crisis concentrated on stricter rules for the banking sector, and a new global standard (Basel III) was developed in 2010. At the time of the G20 Seoul Summit in November of that year, the attention of policymakers turned to shortcomings in and unintended consequences of the emerging regulatory framework. Aware of the threat of regulatory

arbitrage and the tendency of risky behavior to migrate to less stringently supervised parts of the financial system, G20 (2010, 41) leaders declared:

“With the completion of the new standards for banks, there is a potential that regulatory gaps may emerge in the shadow banking system. Therefore, we called on the FSB to work in collaboration with other international standard setting bodies to develop recommendations to strengthen the regulation and oversight of the shadow banking system by mid-2011.”

The FSB created a Task Force co-chaired by Adair Turner, Chairman of the UK FSA at the time and Jaime Caruana, General Manager of the BIS, two seasoned regulators and important officials within the FSB. The Task Force published a report in October 2011 that would provide the foundation of all subsequent regulatory work in this area (FSB 2011a, 2011b).

The term shadow banking was coined by Paul McCulley, Managing Director of the asset management firm PIMCO at the time of the outbreak of the crisis. In a paper from September 2007, McCulley interpreted the unfolding US subprime mortgage crisis as a “run on the shadow banks”. In his view, liquidity injections by the Federal Reserve were insufficient to salvage the highly leveraged non-bank investment channels used by banks to keep loans off their balance sheets because banks themselves were reluctant to extend credit to the shadow banking system. (McCulley 2007). This conception of shadow banking as derived from the crisis experience in the United States and other developed economies has had a long-lasting impact on the shadow banking frame on the global stage.

The negative connotation of the frame was never undisputed. From the beginning, the FSB recognizes that shadow banking can be advantageous for the economy, providing an alternative source of funding and liquidity and improving the efficiency of credit allocation. However, this acknowledgment is always followed by the assertion that the global financial crisis showed that shadow banking can become a source of systemic risk. Similarly, the term shadow banking itself drew criticism for denigrating what some FSB members would prefer to call “market-based finance”. In order to address this concern, regulatory documents usually contain a footnote clarifying that no pejorative association is intended, and that the use of shadow banking follows the G20 and common practice (FSB 2011a, 2012).

In spite of this assertion of neutrality, shadow banking in the FSB frame is a site of potential risk and regulatory arbitrage rather than a vehicle for more efficient credit allocation and financial inclusion. The October 2011 publication, endorsed by G20 leaders at their Cannes Summit makes that clear. Entitled “Recommendations to Strengthen Oversight and Regulation” the document provides a definition of shadow banking and a set of measures to bring risk-prone parts of the sector under tighter regulatory control. It outlines general principles including a focus on externalities and unintended consequences as well as proportionality in implementing regulatory measures. Regulators are also encouraged to take into account the particularities of their respective jurisdictions. At the same time, the FSB highlights the need to implement shadow banking regulation in an “internationally consistent” (p. 16) fashion in order to avoid cross-border arbitrage. Flexibility in monitoring the sector is encouraged, but only to “capture innovations and mutations in the system that could lead to growing systemic risks as well as to arbitrage that undermines the effectiveness of financial regulation” (p. 4). The FSB frame is thus incompatible with the notion of encouraging financial innovation in the shadow banking sector. Promoting the growth of the sector for the sake of financial inclusion is also anathema to this frame (FSB 2011b).

After two additional years of work the FSB published a policy framework that provides policymakers with concise tools to tighten the regulatory screws on risk-prone areas of the non-bank financial sector and “capture new structures or innovations that create shadow banking risks” (FSB 2013, 6).

At the time of publication, all 24 FSB member jurisdictions declared their willingness to participate in an annual system-wide shadow bank monitoring exercise and peer reviews.

It is important to note that the FSB policy framework does not create any legal obligation to tighten the regulation of non-bank financial intermediaries. In fact, no agreement by the G20, the FSB, or the standard setting bodies it coordinates are legally binding. Instead, these government networks operate on the basis of peer pressure and reputation. FSB members subject their national regulatory approach to external scrutiny by their colleagues abroad and make their collective assessment publicly available. Laggards or deviant jurisdictions risk being labeled as such. In the world of finance, such threats to reputation carry significant tangible and intangible implications. Thus, even though participation in peer reviews and monitoring exercises does not reduce *de jure* regulatory sovereignty, it may impose *de facto* constraints on regulatory agencies, especially those with the responsibility to oversee large portions of the global shadow banking sector.

In sum, from the 2010 G20 Seoul Summit onwards, the FSB developed a frame of shadow banking as the source of unmonitored systemic risk. The frame is rooted in the experience of developed economies and lessons from the financial crisis that had its epicenter in the United States. Notions of shadow banking as a vehicle for financial inclusion, efficient credit allocation, and diversification of investment channels are of marginal relevance to this frame. While the FSB acknowledges the need to balance costs and benefits in designing proportionate regulation, it precludes the notion of outright promoting the shadow banking sector for the sake of greater economic development. Financial innovation in the FSB shadow banking frame is understood as regulatory arbitrage, worthy of being “captured” rather than encouraged.

The establishment of the shadow banking frame coincides with the development of another frame regarding non-bank financial intermediaries, namely financial inclusion. At the Pittsburgh Summit in September 2009 the G20 decided to launch a G20 Financial Inclusion Experts Group with the help of the World Bank (IFC) and the Consultative Group to Assist the Poor (CGAP), a coalition of governmental development agencies, multilateral development banks, and foundations. At the Seoul Summit in the following year, G20 (2010, 55) leaders stated:

“We reiterate our strong commitment to financial inclusion and recognize the benefits of improved access to finance to lift the lives of the poor and to support the contribution of SMEs to economic development.”

The financial inclusion frame is situated within a development discourse that exhibits clear differences to the shadow banking frame of regulators. Here, innovative financial services by banks and, above all, non-bank financial intermediaries are understood as a vehicle to support development financing from public and private sources. Access to finance is a means of improving living standards among the poor and of narrowing the development gap, a new tool in the hands of development experts. The function of regulation is to maximize the benefits of financial sector growth. The notion of systemic risk is not part of this frame, and concerns regarding negative repercussions primarily revolve around customer protection. Furthermore, the financial inclusion frame highlights the differences between individual countries and emphasizes the need to tailor policies to local conditions. International consistency of regulatory measures is neither necessary nor desired. The purpose of gathering policymakers from different countries is to share best practices in promoting the sector, not to prevent free-riding and regulatory arbitrage.

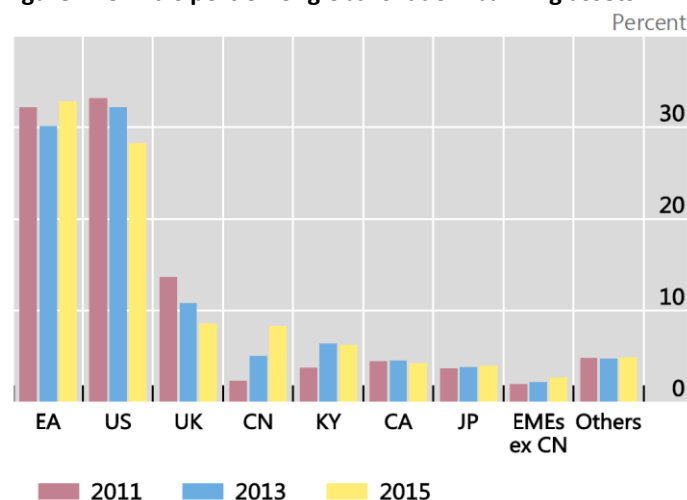
It might seem surprising that two frames covering non-bank financial services with vastly different epistemological roots, objectives and normative implications appear on the same G20 declaration merely 14 paragraphs apart from each other. However, very few people would draw a connection between the two at the time. The shadow banking frame was developed by regulators concerned

with stability in the most developed financial markets. Developing countries remained largely under the radar of this group because they were not expected to nurture financial markets of a size and complexity that could generate systemic risk in the foreseeable future. The financial inclusion frame in contrast was established by development experts and development officials with low- and middle-income countries in mind. The issue of financial inclusion in advanced economies was seen as largely solved and not a priority for the G20 in any case. Their proximity in the Seoul Declaration is thus merely a by-product of the G20 policy sausage-making process whereby deliverables from a wide variety of ministries and agencies are lined up for negotiation and consensus generation.

Evolution of Shadow banking in China

The part of China's financial sector that falls under the FSB definition of "credit intermediation involving entities and activities (fully or partially) outside the regular banking system" (FSB 2013, ii) is small in terms of GDP when compared with advanced economies. Estimates of the size and composition of China's shadow banking system are fraught with problems of over- and under-counting and consequently range widely, from 5 to 46tr RMB (0.7 to 6.9tr USD) at the end of 2013, equivalent to between 8 and 80% of GDP at the time (for a list of recent estimates see Elliott, Kroeber, and Qiao 2015). Even at the higher end of that range China's shadow banking sector is smaller than the average of FSB member countries (120% of GDP), and certainly smaller than that of the United States (150%) and the United Kingdom (650%). Nevertheless, China's shadow banking sector is larger than that of comparable developing economies, and it is growing at a faster pace than any other country (Sheng and Soon 2016; Elliott, Kroeber, and Qiao 2015; Yan and Li 2014). According to FSB estimates, China's share of global shadow banking assets has grown from 2% in 2010 to 8% in 2014, overtaking all developing and most developed countries to rank fourth in size, only after the Euro Area, US and the UK (FSB 2017).

Figure 1: China's portion of global shadow banking assets



EA – Euro Area, US – United States, UK – United Kingdom, CN – China, KY – Cayman Islands, CA – Canada, JP – Japan, EMEs – Emerging Market Economies

Source: FSB (2017, 17)

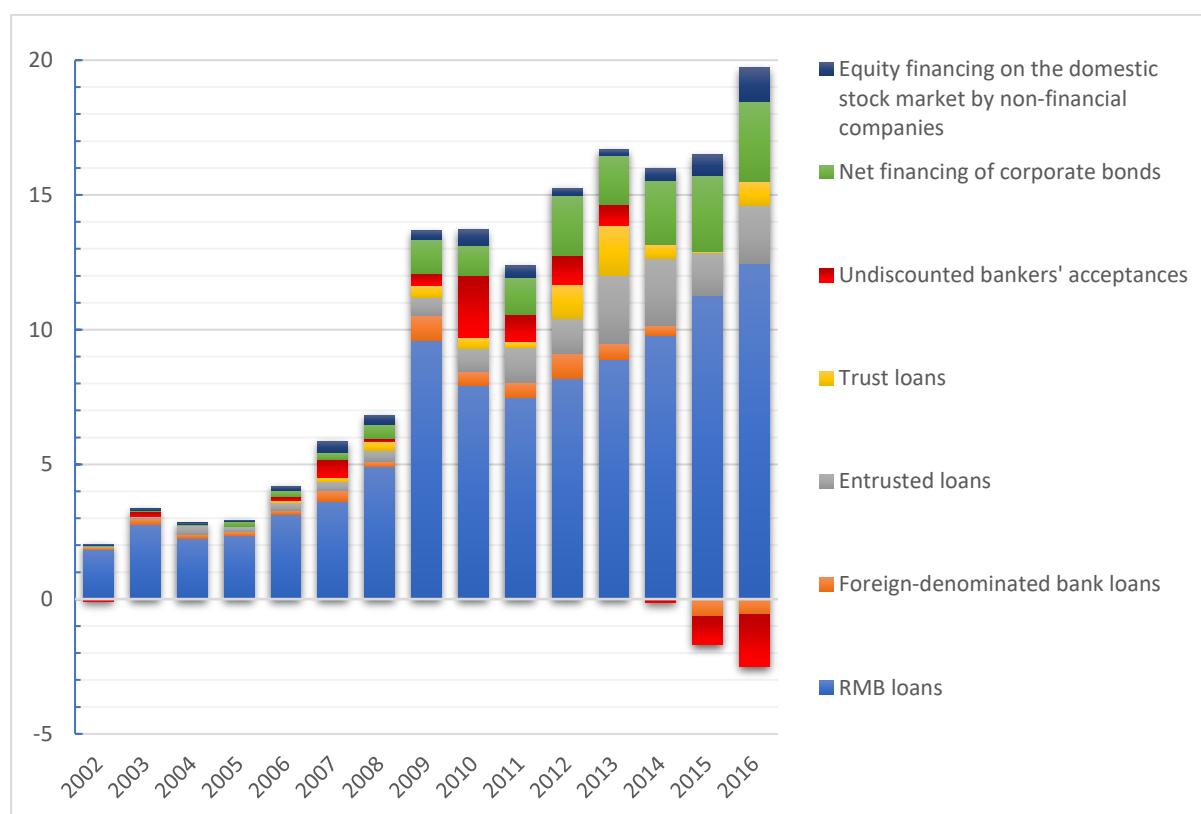
Three drivers bear responsibility for the rapid growth of non-bank credit intermediaries in China. First, China's bank-dominated financial system is geared towards providing loans to large, state-owned companies. With plenty of collateral to pledge and implicit or explicit political backing, these large firms represent a low-risk customer base for China's large banks. Capital markets do not provide small and medium enterprises with sufficient access to financing either (Elliott and Qiao 2015). Shadow banking thus provides what Sheng and Soon (2016, 8) call a "roundabout market response to real sector funding needs".

Second, China is a country with an astoundingly high savings rate but limited investment options both for retail and corporate customers. Under a system of financial repression, the formal banking system has been subject to interest rate caps until very recently, providing depositors with low and at times even negative real interest rates (Lardy 2012; Zhang 2012). These drivers are the two sides of the same coin. Xie Ping describes this situation as the “two abundant two difficult” (两多两难) problem of China’s financial system: Private savings are abundant but lucrative investment channels are difficult to access, and smaller, private companies in need of financing are abundant but they find it hard to obtain credit (Xie 2013).

This situation has been exacerbated by a third driver, the clampdown on formal credit growth in the wake of the global financial crisis. China was able to stave off a slowdown in economic expansion thanks to a 4tr RMB stimulus package in 2008/9, most of which took the form of credit growth through the banking sector rather than fiscal expansion. Fearing inflationary pressures and asset bubbles in the housing market and elsewhere however, financial regulators decided to curb further credit growth in 2010. Furthermore, Beijing decided to implement Basel III in a particularly conservative way.

Constrained by quantitative lending caps, a loan-to-deposit ratio of 75%, active discouragement by regulators to lend to certain sectors (such as construction), a high reserve requirement ratio imposed by the People’s Bank of China (PBOC), high Basel III capital requirements and limited pricing flexibility, banks started engaging in regulatory arbitrage. By cooperating with trust, guarantee and financial leasing companies as well as by creating substitutes for formal retail deposits such as wealth management products (WMP), banks created a wide array of channels for off-balance sheet credit intermediation. In this sense, the shadow banking sector in China is often described as the “shadow of the banks” (Sheng and Soon 2016; Elliott, Kroeber, and Qiao 2015; Schwarcz 2013; G. Zeng 2013).

Figure 2: Net flows of aggregate financing to the real economy, (in tn RMB)



Source: PBOC

The structural features of China's shadow banking system reveal many differences and a few similarities with those of advanced economies. Size is certainly a difference, as shadow banking assets in the United States and the United Kingdom dwarf those of China relative to GDP. The main financial vehicles and institutions are also different. The Chinese shadow banking sector is dominated by trust products (loans extended/guaranteed by trust companies), entrusted loans (inter-company loans brokered by financial intermediaries) and wealth management products (deposit equivalents that channel savings into corporate bonds and loans). In advanced economies, shadow banking in contrast is centered around asset managers, money market funds, hedge funds and instruments of securitization. These dissimilarities in turn correspond to differences in the type of investors and selling platforms. While in advanced economies the main actors are institutional investors operating in capital markets, in China banks play a fundamental role, and retail investors are the dominant investor group (Yan and Li 2014, 87ff; Shen and Huang 2016; Chen 2014).

This last set of differences has significant repercussions for regulatory action: In advanced economies, securities regulators have core responsibility for overseeing the shadow banking sector, while in China the banking regulator (CBRC) carries out the large majority of supervisory work. Moreover, the massive involvement of retail investors and the benefits of for SME financing make the Chinese shadow banking sector compatible with a financial inclusion frame in ways that its counterparts in advanced economies are not.

What unites shadow banks across the globe on the other hand is regulatory arbitrage. The growth of China's shadow banking sector may be attributable to efforts at avoiding the strictures of conservative banking supervision. As Elliott et al (2015, 20) point out: "Banks would likely provide the great bulk of this lending directly and hold it on their balance sheets were there not a series of regulatory constraints on the amount and pricing of their loans."

Frame dispute

In the years following the shadow banking frame establishment by the FSB, Chinese economists started researching the particularities of the domestic shadow banking sector. Nearly all studies consulted for this article point out the structural differences between the notion of shadow banking in advanced economies and China's shadow banks along the lines presented in the section above. On the basis of this research, Chinese policymakers became increasingly vocal and assertive in highlighting the mismatches between the FSB shadow banking frame and the realities in China and other developing countries.

There is no evidence to date that Chinese regulators disputed the contours of the FSB frame at the time of its establishment around 2011 (Zheng 2016). Zhou Xiaochuan, Governor of the Central Bank of China, was among the first to utter cautious disagreement in late 2012. At the 18th Congress of the Chinese Communist Party Zhou noted that even though China has its own shadow banking system, it is much smaller in terms of size and risk than those of advanced economies (Xinhua 2012). Shang Fulin, newly appointed Chairman of the CBRC at the time, followed up in highlighting that so-called shadow banking products such as WMP and trust products are not un-regulated but rather within the supervisory perimeter of his agency.

A thorough report prepared by the Chinese Academy of Social Sciences in 2013 and 2014 goes one step further. It recognizes that China's shadow banking sector contains risks derived from maturity and liquidity mismatch and imperfect credit risk transfer, but argues that the risk of triggering a systemic crisis is very small. The policy recommendations of the authors are compatible with the FSB frame in that they encourage greater transparency, and a series of regulatory measures to improve risk pricing and resilience. However, they depart from the international frame by arguing that policy

measures should be guided by the overarching principle of ensuring that the financial sector serves the real economy. As a consequence, they encourage policymakers to promote the healthy growth and development of the shadow banking sector (Chinese Academy of Social Sciences 2013; Zhang, Gao, and Liu 2014).

In its 2013 Financial Stability Report, the People's Bank of China challenges the FSB frame to a greater extent, arguing that because "national financial systems and regulatory frameworks are far cry from one another, there is not an agreed-upon and clear-cut definition for shadow banking till now." (PBOC 2013, 199). Nevertheless, the definition put forward in the report matches the one of the FSB ("credit intermediation involving entities and activities outside the regular banking system, with the functions of liquidity and credit transformation which could potentially cause systemic risks or regulatory arbitrage"). Unlike the FSB frame that pays only marginal attention to the benefits of shadow banking, the PBOC states that: "As an integral part of financial market in a broad sense, shadow banking plays a positive role in facilitating *social investment and financing*." (PBOC 2013, 199, emphasis by authors). It thus lays the foundation for an alternative version of the shadow banking frame as a vehicle for financial inclusion rather than a source of systemic risk and regulatory arbitrage.

The report does acknowledge that shadow banking contains risks that leave regulators with little margin for error. It admits that the growth of the sector undermines the effectiveness of macroeconomic policies, recognizes the likelihood of contagion in the event of market turmoil, and that small loan companies and pawn shops are lacking standardized supervision. The overall policy direction however is optimistic in that the benefits of financing channels outside the regular banking system outweigh the disadvantages. As the central bank puts it: "The whole financial market gets a shot in the arm by shadow banking in liquidity and dynamics." (PBOC 2013, 204).

While the PBOC challenges the connotation of the term shadow banking, two leading Chinese banking regulators dispute its definition and outlook. Yan and Li (2014, 41ff) distinguish between shadow banks in the wider (non-bank credit intermediation) and in the narrower sense (posing systemic risk). The authors thus downgrade regulatory arbitrage as a problem indicator. The large majority of China's shadow banking institutions and instruments fall into the first category, undeserving of stricter regulatory control. More fundamentally, Yan and Li (2014, 280ff) argue that shadow banking regulation must take into account developmental stages. Similar arguments are made by the finance research deputy director of the State Council Development Research Center, Ba Shusong, and leading financial regulators from the region (Ba 2010; Sheng and Soon 2016). This influential group of financial policymakers thus explicitly link shadow banking regulation with the prerogatives of economic development, an intellectual innovation that is anathema to the FSB frame.

The dispute between the FSB frame and the one developed by Chinese policymakers reached the international stage in 2014 (Zheng 2016). While significant debates have likely occurred within the FSB, no public documentation to provide evidence is available to date. Instead, the frame dispute on shadow banking surfaced in one of the six regional consultative groups (RCG) that are designed by the FSB to engage non-members in regulatory deliberations. The RCG for Asia commissioned a survey asking regulators in the region to identify non-bank financial intermediaries (NBFIs), report the degree



of current supervisory control over them and assess the risk they pose for the financial system. After its meeting in August 2014, the RCG produced a report on shadow banking, parts of which are worth quoting at length:

“Members recognize the beneficial roles played by NBFIs [non-bank fin entities] in filling a credit void and broadening access to finance by individuals and corporations which may not otherwise benefit from access to “traditional” sources of funding. These positive attributes of NBFIs are of significant socio-economic value to most jurisdictions in the region. NBFIs promote financial inclusion and sustain growth, in particular for emerging and developing markets, where further deepening of financial markets is a priority. In addition, the activities of NBFIs identified in the survey are predominantly domestic and thus, cross-border risks are minimal.” (FSB RCG Asia 2014, 6).

The report is remarkable for three reasons. First, it openly disputes the FSB frame on shadow banking as primarily a source of risk rather than a vehicle for economic development. Second, it distinguishes between domestic and cross-border systemic risk, opening up discursive space for greater sovereignty in regulating the domestic financial sector, a move away from “international consistency” in standards implementation. Third, it promotes shadow banking as a vehicle for financial inclusion and highlights the special needs of emerging and developing markets.

The last point is of special significance when taking into account that both developed (Japan, Korea, Australia, New Zealand, Singapore) and developing countries comprise the Regional Consultative Group, and that decisions such as this report are made by consensus. In fact, the report explicitly states that “None of the members consider that Asia faces the same shadow banking risks as other jurisdictions such as the US or EU.” (FSB RCG Asia 2014, 9). The RCG recommends the FSB to reconsider its approach to shadow banking regulation, taking into account developmental needs, its functionality in bridging a financing gap between savers and borrowers, and a differentiated treatment of non-systemic risk.

Just as remarkable as the RGC Asia report is the lack of response by the FSB. Its 2015 information sharing exercise and 2016 thematic peer review do not entertain any of the challenges put forward against the FSB frame. The report dedicates three lines in a section titled “background” to the benefits of shadow banking and continues with the well-known argument that the financial crisis revealed shadow banking as a source of systemic risk. The clarification that shadow banking is not intended to cast a pejorative tone is relegated to the usual footnote. The peer review concludes that “More work is needed to ensure that the Framework’s application is rigorous enough for jurisdictions to comprehensively assess and respond to potential financial stability risks posed by non-bank financial entities, and to support FSB risk assessments and policy discussions.” (FSB 2016, 3).

Contrary to the distinction between domestic and cross-border risk as proposed by the RCG Asia, the design of the FSB information sharing exercise takes a “conservative approach”, covering all entities that could “give rise to shadow banking risks in at least one jurisdiction” (p. 28). The report does not entertain the idea of a differentiated approach to shadow banking for developing countries and merely takes note of the need for the FSB to “resolve material differences of view and thereby promote greater consistency in the classification of non-bank financial entities.” (p. 6).

A closer look reveals the fault lines underneath the peer review. Chinese regulators did not engage in detailed a classification of shadow banks, and only the CBRC cooperated in the information sharing exercise, not the securities regulator. A footnote in the country report card in the appendix states that “The Chinese authorities did not agree with the classification of certain entity types as shadow banking.” (FSB 2016, 93). Recently, Chinese regulators appear to have reduced the degree of information sharing with the FSB even further. The newest shadow banking monitoring report to

date notes that “China is not included in the narrow measure of shadow banking presented in this Report, due to delays in the submission of relevant data and information.” (FSB 2017, 44).

What conclusions can be drawn from this series of events? From the evidence available to date, at the very least it is clear that there exists a significant measure of dissatisfaction amongst Chinese financial regulators with the FSB’s post-crisis framing of the shadow banking issue. Further, Beijing has actively contested this frame through the existing institutional mechanisms of consultation, negotiation, and peer review, but with seemingly few results to show. Arguably, Chinese regulatory agencies have dedicated limited efforts to the FSB peer review after it became clear that the global regulatory body was not willing to adjust its frame of shadow banking, even in the face of concerted criticism by both members and non-members in Asia. The next section turns to another way that Chinese agencies are able to contest the FSB’s regulatory discourse: the establishment of internet finance as a competing frame for the regulation of non-traditional financial services.

Frame shift: Internet finance

Coincidental with the unresolved frame dispute regarding shadow banking, new technological and business developments in China led to the emergence of a novel frame. Centered around the term “internet finance” (互联网金融), the frame encompasses all digital financial services. Xie Ping and Zou Chuanwei (2012) attribute the coining of the term to themselves, even though it appears in the English language over a decade earlier, namely in a 1998 RAND Corporation report on cyberspace and money laundering (Mussington, Wilson, and Molander 1998; Molander, Mussington, and Wilson 1998). Unlike the RAND report that highlights the risks associated with internet finance, the vast majority of Chinese authors to date cast digital financial services in a very positive light.

Xie et al. (2014, 6) highlight the contrast between old and new finance: The old financial system is characterized as elite-based and exclusive. Internet finance in contrast is driven by the openness, simplification, fairness, and the freedom of choice. The authors even argue that the internet brings about “financial democratization” (金融民主化), a stunning instance of enthusiasm in a country where the government makes considerable efforts to prevent its population from freely accessing content on the internet.

Internet finance in China took off in 2013 when the dominant internet companies made concerted moves to offer financial services. Retail giant Alibaba launched Yu’E Bao, an electronic wallet, Sina (a blogging website) established Microbank, Tencent (a chat platform) unveiled its Wechat payment service, and Baidu (a search engine) began selling wealth management products online (Chen 2014). The digital financial services sector in China has grown at double-digit rates in terms of assets, customers, and transaction volumes over the last few years, outpacing its Western counterparts.

Table 1: Frames of non-traditional financial services

frame	shadow banking (2010)	financial inclusion (2010)	internet finance (2013)
advantages	alternative source of funding and liquidity (in certain circumstances)	financial sector development, economic growth, poverty reduction	more efficient credit allocation economic growth, competitiveness
disadvantages	regulatory arbitrage systemic risk	none contemplated	none contemplated
meaning of innovation	regulatory arbitrage	inclusiveness, growth engine	higher productivity, higher efficiency
meaning of risk	threat to financial system	threat to individual customers (fraud)	threat to individual customers (privacy, fraud)
adequate policy response	strengthen monitoring strengthen regulation	promote sector growth	promote sector growth
purpose of regulation	curb systemic risk capture innovation	maximize benefits of sector development	maximize benefits of sector development
developed from experience in	advanced economies	developing countries	(China)
developed by	financial regulators, central bankers	development ministries, MDB, foundations, NGO	government (State Council)
cross-border harmonization necessary	yes, to curb regulatory arbitrage	no, development stage and country context matter	no

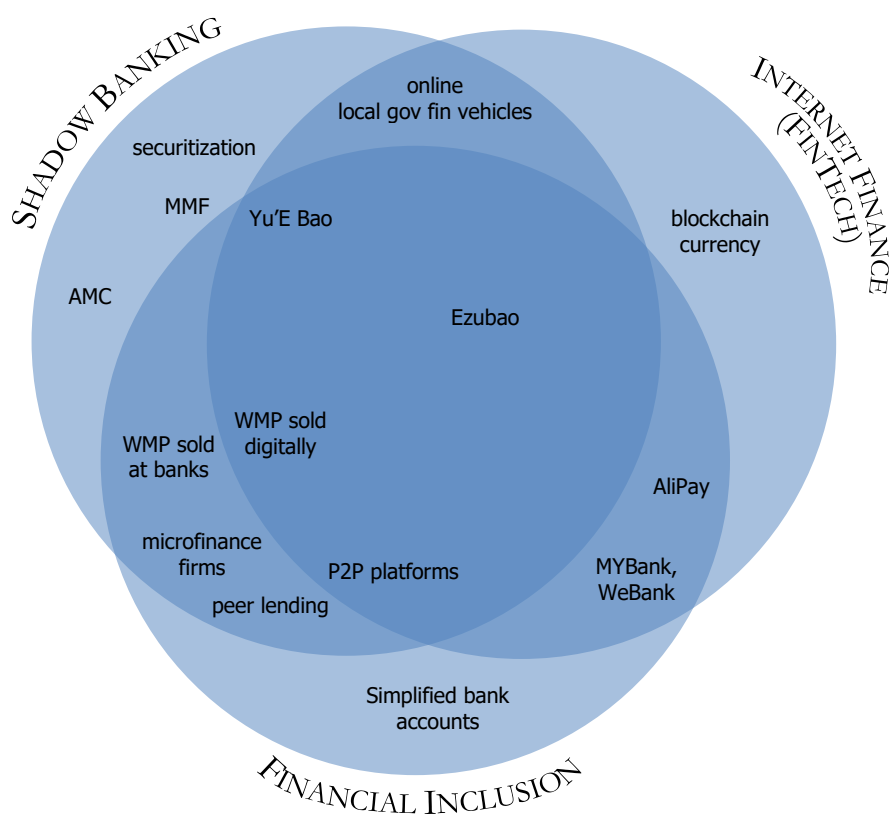
The frame of internet finance is wide, covering phenomena as diverse as mobile payment services, e-money, big data-driven credit and loans, peer-to-peer (P2P) lending, and the provision of traditional financial services online. Some of the services subsumed under the internet finance frame are truly unprecedented, such as big-data credit assessment systems, but many are shadow banking products with a digital veneer. Two examples serve to illustrate the significant overlap between the internet finance and shadow banking frame: Yu'E Bao and P2P financing platforms.

Yu'E Bao (余额宝, "leftover wallet") is a service originally developed by Ant Financial, a spin-off from Alibaba, China's largest retail platform operator. Customers can transfer money from their formal banking account to Ant Financial's Alipay, and Yu'E Bao allows them to earn interest on whatever amount they have not used to settle their purchases. In fact the service is a Money Market Fund (MMF) created in a joint venture between Ant Financial and Tianhong, an asset management company. Unlike common MMF, there is no minimum threshold to invest in this fund. The Chinese securities regulator stated in June 2013 that it welcomes this development, providing an enabling environment while taking into account customer protection. By mid-2017, Yu'E Bao's customer base exceeds 300m people, and it has become the largest MMF worldwide with over \$165bn under management (Zhou, Arner, and Buckley 2015; Ma 2017).

Peer-to-peer (P2P) platforms are online sites where companies and individuals in need of financing are matched with interested investors. Most P2P platforms in China operate as fixed income markets where the duration and interest on a loan are negotiated among the parties. Only a few platforms

provide equity financing. From 2010 to 2015, the number of P2P platforms in China has risen from less than a dozen to over 2500, doubling in the second half of 2015 alone. At the same time, issues of fraud, defaults, and payment delays have become widespread. The most egregious case to date is the collapse of Ezubao in December 2015, an alleged Ponzi scheme involving \$7.6bn and over 900'000 investors, but to date “problem platforms” constitute about a third of the total (Ho 2015; Chorzempa 2016). Both the business model and its problems have historical roots in the shadow banking system. For decades if not centuries, peer finance (民间金融), that is lending within family or business networks is common practice among small and medium enterprises that are unable to obtain loans from the regular banking system. The entrepreneurial town of Wenzhou was the site of a policy experiment in liberalization of peer finance in 2011-12, with rather disastrous consequences. The words “boss on the run” (老板跑路) became the top search term on the Chinese internet in 2011, highlighting the susceptibility of lightly regulated peer finance to fraud and deception years before the Ezubao scandal (Chen 2014, 33ff; J. Zeng 2015).

Figure 3: Frames of non-traditional financial services¹



In sum, while internet finance and shadow banking are not synonymous terms, they cover a largely overlapping universe of non-bank financial services. Some financial experts acknowledge this straight away. Sheng and Soon (2016, 171) note: “Leveraging on technology, shadow banking activities in China have increasingly become digitized, enabling them to scale up at low cost with wider geographical and market reach”. Similarly, Chen (2014, 185) argues that Alibaba, in being incompatible with the current regulatory framework, has become a “huge shadow bank”.

¹ The authors thank 熊爱宗 for the inspiration underlying this figure

Consequences of frame shift

The frame shift from shadow banking to internet finance is not merely a discursive phenomenon. In line with Goffman's original approach, frames also provide actors with a selection of practical actions, and it confers legitimacy to some but not others. In the case at hand, the difference between the two frames resides in the government response at the domestic level and the policymaking space at the international level. Let us examine each in turn.

In approaching non-banking financial sector regulation at the domestic level, the government always had to find a balance between risk control on the one hand and support for innovation and development on the other. Under the shadow banking frame, policy actions were skewed towards the former. The State Council, the PBOC and the banking regulators issued a series of notes, guidelines, and regulations to slow down the pace of shadow banking credit growth, limit financing to local government financing vehicles, eliminated the most opaque of shadow banking instruments, raised capital requirements for others, and instituted exposure limits on individual counterparties in the interbank market, among others (Elliott, Kroeber, and Qiao 2015). Thus, while prominent intellectuals and regulators became increasingly vocal about the benefits of shadow banking, regulatory policy itself remained largely aligned with what the FSB would consider global best practice. The government may have allowed regulators to engage in a frame dispute at the FSB Regional Consultative Group, but it never endorsed any policy that would promote growth and innovation in the shadow banking sector.

That changed as a consequence of the shift to the internet finance frame. Not only is internet finance understood as a vehicle for financial inclusion (just like shadow banking in China), but also as an efficiency-enhancing and growth-generating driver of structural reform in the domestic financial sector and the source of future competitiveness in global markets. The first State Council documents that mention internet finance in August 2013 refer to the need to encourage financial innovation in order to widen financial support for SME and increase domestic demand. In March 2014, Li Keqiang emerged as a relentless supporter of financial innovation, vowing to promote the "healthy development of internet finance" (Xie, Zou, and Liu 2014, 12f). In the following year, the Premier officiated the opening of WeChat's online bank with the words: "It's one small step for WeBank, one giant step for financial reform." (Wildau 2015).

The enthusiasm of China's government regarding internet finance may be most evident in the P2P sector. Until 2015, regulators maintained a "let the bullets fly" (让子弹飞) attitude vis-a-vis the mushrooming sector. Instead of being required to obtain a license from a financial regulator, P2P platforms register as "information intermediaries" with the local Industry and Commerce office. That has not changed even after the issuance of a series of internet disclosure standards and regulations by the PBOC in 2015 and the CBRC in August 2016. Unlike the latter authorities, local commerce bureaus are designed to promote the growth of the sector, not to assess and curb its contribution to systemic risk. In addition, the tenuous connection of online platforms to a particular location leaves these financial firms with plenty of scope for regulatory arbitrage, as Chinese internet finance experts readily acknowledge (Sohu 2016; Yan and Li 2014, 208; Xie, Zou, and Liu 2014, 212ff).

At the international level, the recalcitrance of government networks to consider the nexus between shadow banking and financial inclusion contrasts with the outright promotion of digital financial inclusion. A shift from the shadow banking to the internet finance frame thus provides Chinese policymakers with much greater policy space and legitimacy to promote non-traditional financial services.

Since the establishment of the financial inclusion frame at the G20 Summits of 2010, policymakers have focused on the benevolent effects of digital technology. Established at the G20 Seoul Summit,

the Global Partnership for Financial Inclusion merely took note of “branchless banking” in its 2011 assessment. Five years later, digital technologies are front and center of its follow-up report. The technical team of the Global Partnership, chaired by officials from the PBOC and the World Bank, worked to transform the 2010 framework for *Innovative* Financial Inclusion into the 2016 High-Level Principles for *Digital* Financial Inclusion. The principles were endorsed by G20 leaders at the Hangzhou Summit in September 2016, along with a plethora of other cooperative initiatives and action plans that promote fintech and digital financial inclusion (GPFI 2011, 2016, G20 2016a, 2016b, 2016c).

The promotion of non-traditional (now digital) financial services for financial inclusion continues to be driven by officials from development ministries, development banks, and foundations, not regulators. The GPFI lauds the work of the Financial Action Task Force but notes that, “in contrast with FATF’s assessment methodology for mutual evaluations, financial inclusion considerations have not yet figured significantly in the other SSBs’ [financial standard-setting bodies] methodologies for standards-related self-assessments and peer reviews” (GPFI 2016, 82). However, since the FSB as an unelected government network is designed to derive political power and legitimacy from the G20 along with its policy initiatives, the strategic shift to digital financial inclusion may push global regulatory networks to take developmental needs into greater consideration when assessing shadow banking.

Most recently, China’s regulators have started to impose stricter controls on the shadow banking system again. In the spring and summer of 2017, officials at the central bank, the CBRC, members of a high-level study group attended by Politburo Party cadres, and President Xi himself highlighted the importance of curbing financial risk for the sake of national security (*Xinhua News English* 2017; *Caixin* 2017; *Bloomberg* 2017). Whether the regulatory crackdown of 2017 has an effect on the growth of shadow banking, internet finance, or the collaboration between Chinese regulatory authorities and the FSB is a question that deserves much attention from researchers and policymakers in the near future.

Conclusion

This article has provided a novel attempt at analyzing the political economy of financial regulatory struggles and negotiations between China as an emerging market economy and global standard-setting bodies. In applying frame analysis to regulation of non-traditional financial services, it highlights the contingency of policymaking space on stakeholders and their frames at the intersection of financial regulation and development. As a representative of the developing world, China has taken the lead in promoting a regulatory approach to shadow banking that strikes a balance between development and risk control. But even after forming a coalition of like-minded Asian financial regulators, Beijing has not succeeded at altering the shadow banking frame as developed by regulators from advanced economy in the wake of the global financial crisis. At the same time, in developing an alternative frame on non-traditional financial services as vehicles of digital financial inclusion, China and other developing countries have gained more policy space both at the domestic and the international level.

Before the global financial crisis, financial regulatory networks were the exclusive terrain of advanced economies both in participation and the application of global standards at least in principle. Global standard-setting bodies (SSB) thus had little incentive to take development prerogatives into account. And even though emerging market economies joined global regulatory negotiations in the wake of the global financial crisis, the policy outlook of SSBs has not changed significantly. In recent years however, a coalition of multilateral development banks, development agencies, and foundations however is working with China and other developing country governments to bring about a shift in attitude in global regulatory networks. Operating through the G20 and using a frame

of (digital) financial inclusion, this coalition may help engender change in global regulatory diplomacy to make future financial standard-setting more attuned to the needs and constraints developing countries face.

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