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A Study on the Problems and Countermeasures of Legal Regulation of Private Lending

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Abstract. Private lending is widespread in China, and as a useful and necessary complement to formal finance, it is becoming increasingly important in the country's economic development process. The activity of private lending is in line with the profit-seeking nature of market players, enabling the effective use of a large amount of idle social capital, and temporarily alleviating the contradiction between the high lending threshold of formal financial institutions and the lack of timely satisfaction of the capital needs of small and medium-sized enterprises, which has contributed to the development of diversified financing methods. However, while playing its irreplaceable role, the overheated private lending market may also leave a series of sequelae to China's immature social and economic structure at any time, including the lack of supervision and management mechanisms, insufficient regulation of intermediaries, the risk of disputes and the impact on financial institutions. This paper presents a comprehensive analysis of the legal regulation dilemma of private lending in China, and discusses the path of private lending regulation from the levels of special legislation, perfecting supporting systems, and prudently handling related disputes, in order to achieve the early realization of sunlight, standardization and legalization of private lending.

Keywords: private lending, law dilemma, regulatory path

1. Introduction

In the early years of its emergence, private lending was mostly for the purpose of solving the financial needs of daily consumption and small-scale production and business, a civil act carried out by borrowers and lenders within a small area, with private law being the main rule. The emergence of a large number of private financial organizations, such as pawnshops, private money changers, cooperative societies, and row societies, contributed to a vibrant private lending market. Both parties have relatively equal rights to take the initiative and make decisions, and they are free to negotiate and agree on the specific content of the loan, such as the amount, interest rate, duration, and liability for breach of contract. Compared to other forms of financing, private lending, as a form of credit formed spontaneously in the course of social and economic development on the basis of blood, personal and local ties, has the characteristics of a limited liability company versus a joint stock company, and therefore the existing legislation also highlights the principle of autonomy[1].

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Since the reform and opening up, China's market economy has achieved rapid development, and the trend of private lending has emerged to raise capital and financing. Small and medium-sized enterprises (SMEs) have seen a sharp increase in their capital needs, but due to the high threshold of bank lending, they can only rely heavily on private lending to solve the development dilemma of difficult financing and have gradually become the main subject of lending[2]. In recent years, speculation in housing, cotton, coal, garlic, hydropower, and other groups of different scales have emerged, and private lending has taken advantage of this "east wind" to expand wildly, and now that the state has increased its supervision and cracked down on the above speculation, more profit-seeking funds have gradually squeezed into the "worst money "The vicious consequences of this have been a wake-up call for us. The intervention of public law regulation has become more and more necessary, but the present system of legal regulation is still imperfect, and tempted by the high-profit returns, private lending often easily evolves into usury, illegal absorption of public deposits, illegal collection of funds, fund-raising fraud, money laundering, and other evil consequences, and may even breed social black and evil forces and violent crimes, which greatly undermine the stability of society, which is deeply worrying[3]. Evidently, the chaos in the private lending market has been a hurdle that must be crossed on the road of China's economic progress - legal regulation is imminent.

2. The Dilemma Faced by the Legal Regulation of Private Lending

2.1. Unscientific Legal System

The single law or administrative regulation on private lending has not yet emerged, and the relevant legal provisions are scattered in various sectoral laws, with the boundaries of similar legal terms unclear and the supporting legal system not yet perfected, resulting in systemic incoherence[4]. Even though the legal status of private lending has been debated for a long time, the existing legal provisions on the criteria for determining the illegality of private lending and the lender's liability for defective guarantees have not been explicitly analyzed, which is different from that of the "underground money market", "illegal operation" and "illegal fund-raising", It is not easy to distinguish between "underground money market", "illegal operation" and "illegal fund-raising", resulting in different legal bases for regulating private lending. For example, although Article 176 of the Criminal Law provides for the crime of unlawful absorption of public deposits, there is no definition of what constitutes unlawful absorption of public deposits, and there is no corresponding judicial interpretation of the above legal terms[5]. It is understood that when judges encounter such private lending cases, they usually base their decisions on the "Measures for the Suppression of Illegal Financial Institutions and Illegal Financial Business Activities" promulgated by the State Council. This is not only contrary to the basic principle of criminal law that "no crime is committed unless there is an express provision in the law", but also has the potential to expand the application of the crime of illegal public deposit-taking [6].

2.2. Specific Legislation is Still Lacking

In the absence of specific legislation, the current legal regulation of private lending lacks uniformity, and the direct provisions are too principled and operable. For example, the relevant provisions of the General Principles of Civil Law and Contract Law do not clearly define the scope of the subjects of borrowing and lending. Many experts believe that all forms of lending activities, including "corporate lending", should be protected by law, as long as they are in line with the principle of autonomy and do not violate legal prohibitions[7]. However, if the relevant provisions of the Measures for the Suppression of Illegal Financial Institutions and Illegal Financial Business Activities and the General Rules on Loans are followed, a contradictory conclusion may be reached.

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In addition, even if it is not "impossible to comply", a closer analysis shows that the lack of basic laws has led to an unpromising legal environment for private lending, and the operation of the law has always encountered one problem after another. The most prominent is the confusing phenomenon of "different lives for the same case" in the trial process, and the results of judicial practice are often difficult to get the public's approval, even triggering the public to compare such crimes with the end of corrupt officials, and then to besiege and criticize the law from the perspective of moral sympathy, making the authority of the law questioned and brewing social instability. The authority of the law has been questioned, creating a factor of social instability[8]. It can be seen that a fragmented legislative model tends to waste legislative resources and is incompatible with the increasingly complex situation of private lending and the recent trend of "universal lending".

2.3. Existing Regulations are Inadequate

Our legislative technology is still immature, and the complicated legal provisions have many loopholes and are sometimes in conflict. The General Principles of Civil Law, the Opinions on General Principles of Civil Law, the Contract Law, the Guarantee Law, the Criminal Law, the Provisions of the Supreme Court on Certain Opinions on the Trial of Lending Cases, the Measures for the Suppression of Illegal Financial Institutions and Illegal Financial Business Activities, and the General Rules on Loans are the main basis for the current regulation of private lending, and the lack of unified guidance for law enforcement and judicial activities makes regulation difficult to imagine. Among the existing legal provisions on private lending, there are conflicting provisions and poor coordination[9]. As we all know, the most sensitive aspect of private lending is the "interest rate", and there is a constant debate on whether to marketize interest rates and on the upper limit of the legal interest rate. The current legal interest rate in China is capped at four times the bank rate for the same period, but according to the People's Bank of China's 2010 survey on the average interest rate for private lending, it is usually between 20% and 30%, which is far beyond the legal range. Another example is Article 124 of the General Principles of Civil Law, which stipulates that in the event of a dispute between the borrowing parties over interest rates if the agreement is unclear and cannot be proved, the interest rate may be calculated in accordance with the interest rate of similar loans from banks; it may also refer to Article 6 of this opinion, which stipulates that the people's courts around the world have certain discretionary power and are limited to four times the interest rate of loans from banks for the same period. The above provisions clearly conflict with the "principle of presumption of no interest" as agreed in the Contract Law, but in judicial practice, the former is applied in preference to[10]. These obvious loopholes and conflicts have seriously affected the effectiveness of private lending regulation and justice, and we can clearly understand that - at present - we must accelerate the pace of improving the legal regulation system of private lending.

3. Measures to Improve the Legal Regulation of Private Lending in China

3.1. Improve Relevant Legislation

Improving the laws and regulations related to private lending to enhance the coordination of the legal system is the most crucial step in regulating private lending in China[11]. Developed countries such as the United States, the United Kingdom, and Japan have adopted special legislation to regulate private lending in an orderly manner, with one special law as the basic law, supplemented by a number of single laws and administrative regulations. The unified legislative value eliminates conflicts between the various systems, and the coordination of legislation and enforcement is then improved.

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In the process of amending the law, attention should be paid to the coordination between the new law and the relevant existing legal provisions. On the one hand, the new law can actively absorb and integrate the relevant provisions of the General Principles of Civil Law, Contract Law, and judicial interpretations; on the other hand, small-scale amendments can be made to existing laws and regulations in order to maintain the coordination of the legal system. The following discussion will take the expansion of the legal subjects of private lending as an example: firstly, the Lenders Regulation should be introduced as soon as possible to increase the flexibility of regulation, granting legal status to some private financial organizations with good performance and more standardized operations, and guiding such organizations as the Taiwan Association, the Bidding Association, and the underground money changers to become organized and institutionalized, which is conducive to the development of a healthy competitive private lending market[12]. At the same time, the existing laws should be amended to provide specific regulations on the organization, establishment procedures, supervision and supervision of private lending organizations, and bankruptcy and liquidation, such as amending the Commercial Bank Law to introduce an orderly competition mechanism for diversified and multi-level commercial banks. Specifically, China can learn from Germany and India to allow the establishment of private banks and set up a hierarchy of entry standards and regulatory controls for banks of the same ownership to defend against the impact of liberalizing the private financial market, and truly allow private capital to enter the formal financial sector and be supervised in the sun[13]. In addition, it is imperative to strengthen the regulation of private lending intermediaries. The regulation of intermediaries in terms of access mechanisms, scope and form of business, exit mechanisms, and legal liability for lifting the veil of legal persons will help enhance the formality of the private lending market. Some experts have even ventured to suggest that microfinance companies, pawnbrokers, guarantee companies, spontaneous financial and industrial collaborative organizations, etc. have their justification for existence and great potential for development, and that such institutions or organizations approved to engage in professional lending business can be taken out from the main body of private lending in the general sense and treated as professional lenders, and regulations on microfinance companies can be formulated to implement more professional management.

3.2. Establishment of a Supporting System

Private lending is a complex financial phenomenon and a highly comprehensive legal act, which is still difficult to be fully regulated by today's inflexible laws. The UK has adopted a comprehensive regulatory approach to achieve the effect of orderly management of the private lending market, without a series of perfect supporting systems such as the marketization of interest rates, information disclosure system, and the establishment of the Office of Fair Trading as a regulatory authority. Therefore, while continuously improving the legislation and regulation of private lending, China should accelerate the reform of relevant supporting measures.

Regulating the conclusion of private lending contracts. Specialized agencies are set up to guide private lending behavior by regulating private lending contracts, and contract filing and contract notarization are vigorously promoted. Due to factors such as the trust bond of acquaintance society and poor legal awareness, private lending usually lacks the constraints of formal contracts, which implies a huge risk of disputes. In the United States, special regulatory bodies have been set up from federal to state levels to form a comprehensive regulatory network, effectively preventing the risks inherent in private lending. A unified model contract should be drawn up, in which the necessary terms and conditions such as the subject of the loan, amount, interest rate, term, and purpose are clearly defined. The committee will then report the corresponding lending situation to the financial consumer protection agency each year, which will publish the information on the lending situation for easy access by the public, thus reducing the incidence of bad lending to a

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certain extent through the power of social supervision. Of course, a distinction should be made in terms of legal effect between contracts that have been filed and those that are filed, thus creating incentives, such as provisions for priority of payment, etc.

Accelerate the construction of a credit collection system for private lending and introduce a self-regulatory model for industry associations. If there is a feasible Credit Law, the government will take the lead, and relevant departments and organizations will join hands to build a basic database of credit information of individuals and enterprises, so that a credit system covering the whole society can be established from the top to bottom, thus continuously improving the credit system of SMEs and providing a reliable institutional guarantee to effectively solve the financing difficulties of private enterprises. Therefore, legal means can contribute to the comprehensive establishment of the credit system, and conversely, the establishment of the credit system can also play a supporting role in regulating the special legislation for private lending. In addition, in order to emphasize the principle of honesty and credit in private lending activities, the establishment of a self-regulatory system for private lending organizations is a good prescription. Drawing on Germany's regulatory model of combining internal and external regulation with self-regulation, and taking as reference the self-regulation model of China's now mature banking association, a private lending industry association can be set up through voluntary membership to guide private lending institutions out of a path of self-regulation and self-development.

3.3. Prudent Handling of Private Lending Disputes

First, the quality of regulatory personnel should be upgraded to deal with the enforcement challenges of soaring private lending disputes. Learning from our pragmatic approach in Taiwan and enhancing enforcement capabilities through specialized training for personnel with supervisory responsibilities in the state administration, the judiciary and their public officials is a sure way to cope with the more variable forms of private lending disputes. The State Council and the Supreme People's Court can issue timely guiding cases on private lending to provide direction for the grassroots regulatory authorities to resolve relevant cases. Local law enforcement agencies should also summarise their experience in handling such disputes in a timely manner and share it with their peers. After the introduction of special legislation, law enforcement officers can also be given regular lectures by renowned legal scholars from universities or lawyers from bar associations who are outstanding in the field, so that theory and practice can be fully integrated to deal with civil lending disputes flexibly and avoid paperwork. We can also play the role of a "legal community" from the side to work together to support the sunshine of private lending.

Secondly, the principle of reversal of the burden of proof is established to balance the interests of justice on both sides. As they say in the legal profession, a lawsuit is a "fight for evidence"! The scarcity of evidence is a judicial problem once a dispute is brought to court, especially for cases of a special nature such as gambling, specialized loan shark lending, and couples as co-defendants, where the litigation materials for fact-finding are often very thin and fairness is difficult to achieve. Even though China's litigation system on evidence has largely been brought into line with international standards, lenders are still in a vulnerable position in our judicial practice of private lending, unable to provide sufficient evidence to prove the existence of an "unfair relationship". We can learn from the mature experience of the UK Consumer Credit Act, which establishes the principle of "reversal of the burden of proof" and leaves the determination of whether there is an "unfair" relationship to the respondent to "prove his innocence". ". Thus, in a specific private lending dispute, if the borrower claims the existence of an unfair relationship and claims the termination of the contract, and the lender or guarantor cannot provide evidence to the contrary, the court will acknowledge the existence of an unfair relationship and deny the lending relationship, thus protecting the interests of the borrower.

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Furthermore, it is important to crack down on illegal financial activities and curb violent debt collection. If the subject of private lending has violated the law, especially in cases of suspected violent crime, it is essential that severe sanctions are imposed and that regulators are strict in enforcing the law in order to establish its authority. At the same time, we must recognize that once private lending is legalized, illegal fund-raising, money laundering, and other criminal activities may become rampant in the form of "legal forms concealing illegal purposes", making legal supervision even more difficult. If loans are difficult to collect, lenders often do not use litigation channels because the Chinese legal consciousness is "litigation averse" and people find the cost of litigation too high. In particular, some illegal loan sharks with exorbitant interest rates often employ debt collection agencies to collect debts with violence and other private remedies, leading to broken families and wives. Therefore, the relevant law enforcement authorities should enhance the initiative of supervision and must resolutely prohibit such illegal and criminal activities to avoid unmanageable negative impacts on social stability.

4. Conclusion

"Half angel, half devil" is a metaphor for the private lending market in China today, which not only relieves the tension of unmet capital needs of small and medium-sized enterprises (SMEs) but also cruelly devours the SMEs that once carried an aura of glory with their usurious characteristics. This study analyses the dilemma faced by the legal regulation of private lending and concludes that there are still many shortcomings in the legal regulation of private lending that need to be comprehensively regulated. We need to look at the effects of this double-edged sword dialectically, and clearly understand that the treatment of private lending, which is now floating on the surface of society, is through a combination of regulation and control, rather than a total denial of overly harsh means of suppression, or an overly indulgent and optimistic approach. Only by guiding it out of the grey area can social stability be further maintained. With the rule of law theory as a guide, a forward-looking perspective, and the endogenous nature of private lending, all sectors of society will work together to improve the relevant laws and regulations to guide private lending towards standardization, thus raising it to the level of sunlight operation and adding a more glorious rainbow to our harmonious society.

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