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HOW CHINA IS RACING TO CATCH UP WITH MONEY LAUNDERERS

Plenty of businessmen overseas remit money back to China through underground banks. It’s certainly necessary to have a law against money laundering, but in the meantime we ought to reflect on why even legally earned money is being moved through underground banks. We won’t be able to fundamentally tackle money laundering until we lower such financial costs.

Pehr

HOW SOE DEFAULT WAVE SHOWS STATE BAILOUTS ARE OVER

For years now, some companies have been taking on new debts to repay old ones. Their efficiency is actually pretty low and they are always running deficits. However, this isn’t reflected in their financial statements and the credit ratings agencies are puppets of the bond issuers. Once these companies are no longer able to keep going back to the bond market for more money, they will find themselves in a debt crisis.

Thanks to Caixin for this report. It gives a voice to a normally muted group in this society. This kind of journalism is a pillar of civil society.

Jamesgc6
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Joining the TPP Won’t Be Easy. China Should Anyway

Complying with some of the CPTPP’s more challenging conditions will be beneficial in and of itself.

China is supporting and participating in a succession of multilateral trade initiatives. As soon as the Regional Comprehensive Economic Partnership (RCEP) was signed, President Xi Jinping stated at the Asia-Pacific Economic Cooperation video summit that “China will actively consider joining the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP).”

Amid the ongoing backlash against globalization and the economic impact caused by the coronavirus pandemic, China’s actions and positions not only help boost the domestic and world economies, but also deepen reform and opening up, assist China’s participation in international governance and provide a strong riposte to unilateralism and isolationism.

The CPTPP officially came into force on Dec. 30, 2018. It represents the highest standard of a new generation of trade agreements and has become a template for future high-standard free trade agreements.

The Chinese government has gone through the process of observing and contemplating how to deal with the CPTPP. The heads of the related departments have trodden carefully around the issue. At last year’s Two Sessions, however, Premier Li Keqiang said “China holds a positive and open attitude toward joining the CPTPP.”

Xi’s latest remarks further reveal the fruits of Chinese policymakers’ thinking on this issue and represent a significant and careful decision. People have long been arguing about whether China should join the treaty. Now there is an authoritative answer, the next questions are: Can we join? When should we join? And how should we join?

The main issue for the Chinese government in considering whether to join CPTPP is undoubtedly a comprehensive weighing of the pros and cons of doing so. There are real gains to be made: According to expert calculations, China’s entry into the CPTPP could boost GDP growth by between 0.74 and 2.27 percentage points and export growth by between 4.69 and 10.25 percentage points.

However, some worry about the potential impacts and challenges of joining the CPTPP. We believe China must also retain a positive and open attitude toward this issue. If China joins the agreement, certain sectors will naturally feel varying impacts over a certain period of time. But this is natural: If it had a small impact, or none at all, what would be the point of joining?

Additionally, we should look at China’s achievements in economic and social development, have confidence in the country’s adaptability, and take a dynamic view, knowing that we will further increase our adaptability during any future negotiations by deepening reform and opening up.

The CPTPP has been dubbed a template for free trade agreements with high-standards. This is not an exaggeration. The treaty has a wide scope, including goods trading, intellectual property rights, environmental protection, competition between state-owned enterprises, and government procurement. Some requirements, such as regulatory consistency, are quite innovative.

When the United States withdrew from the agreement’s previous incarnation, the Trans-Pacific Partnership (TPP), some 22 clauses were suspended, making the CPTPP more inclusive. However, its basic orientation has not changed, and its standards still exceed most existing multilateral trade and investment agreements. Meeting the requirements is not easy, even for advanced economies: Japan, a leading CPTPP signatory, has made major compromises in fields like agricultural products, which have proved quite controversial domestically.

First of all, it should be noted that the CPTPP is by no means unattainable for China. In fact, the country has already met the vast majority of its terms. In recent years, China has continuously deepened institutional reform and opening, especially in the financial sector, and is moving forward with the construction of free trade zones. All these developments have laid a solid foundation for China to join the CPTPP.

However, the agreement obviously carries challenges and possible impacts on China. Scholars generally believe that it will be relatively harder for the country to accept clauses on the national treatment concerning goods and market access; investment; state-owned enterprises and designated monopolies; and intellectual property rights. Some clauses on e-commerce and labor are unlikely to be accepted at all.

We must base our judgments on rigorous and accurate inquiry to avoid drawing implausible conclusions. For example, the CPTPP’s rules on state-owned enterprises are often regarded as a major obstacle for China. However, some scholars have said after intensive research that the relevant regulations are actually highly consistent with the constraints that China has accepted under the framework of the World Trade Organization, and the few new constraints may not be completely unacceptable.

We should bear in mind the long-term development of China’s economy and society when considering whether to accept terms that currently seem harsh. Part of this has to do with what the government calls the “second centenary goal,” namely to make China a prosperous, democratic, civilized and harmonious modern socialist country by 2049.

The conditions for the CPTPP are now far more favorable to China and it can take a positive attitude toward joining. Once our policymakers have made a strategic decision, the relevant departments should formulate a timetable and roadmap for joining the CPTPP as soon as possible.
After weeks of space travel, China’s Chang’e 5 lunar probe returned to Earth. On Dec. 17, a capsule carrying about two kilograms (4.4 pounds) of rock and soil samples landed in the northern region of Inner Mongolia, the first time moon samples have been brought back to earth in more than 40 years.

Part of Hukou Waterfall, China’s second largest, froze over after the temperature dropped in early December in the northern province of Shanxi.
A Chengdu resident is tested for coronavirus on Dec. 5. The city of Chengdu took a ‘wartime’ footing after seven locally transmitted Covid-19 cases were reported in two days early in December.

Shanghai coffee shop Hinichijou has gotten a lot of attention from its novel way of doing business. Hordes of customers mobbed the cafe early in December to have the experience of getting coffee served by a furry bear claw through a hole in the wall. Hinichijou’s founder said the initial purpose of the cafe was to employ disabled people who have trouble getting work.
China’s Dream to Lead in Digital Currency

The future of money is electronic and Beijing wants to own it

By Hu Yue, Wang Liwei and Luo Meihan

While most of the world’s governments are still focused on defeating the novel coronavirus that’s plunged the global economy into its worst slump since the Great Depression of the 1930s, central bankers are gearing up to tackle what could become one of the biggest financial challenges of the new decade — digital currency.

The People’s Bank of China (PBOC), which started research on a digital yuan as far back as 2014, is leading the field and is likely to be the first major economy to introduce a sovereign digital currency — it was beaten to the top spot by the Bahamas, whose central bank launched its Sand Dollar in October. The PBOC has already finished building the infrastructure for its Digital Currency Electronic Payment (DCEP) system and has been carrying out localized testing in cities including Shenzhen and Suzhou although no date has been set for its official launch.

Draft revisions to the central bank law published on Oct. 23 include clauses that provide the legal framework for DCEP, giving the digital yuan the same legal status as the physical yuan. And China’s long-term plan for the economy through 2035, released after the Fifth Plenum of the Communist Party Central Committee, which took place at the end of October, refers to “steadily advancing digital currency research and development.”

As it gears up for the domestic launch of DCEP, China also wants to make sure it has a seat at the global digital-currency
Over the past few months, President Xi Jinping himself has highlighted the need for China to get involved in setting international standards and formulating global rules to handle risks to make sure it retains its competitiveness.

“We should… actively participate in formulating international rules on digital currency and digital tax to create new competitive advantages,” Xi wrote in an October article published in Qiushi, the Communist Party’s main theoretical journal. And in a speech at a summit of leaders from the Group of 20 nations on Nov. 21, he called for the organization “to discuss developing the standards and principles for central bank digital currencies (CBDCs) with an open and accommodating attitude, and properly handle all types of risks and challenges while pushing collectively for the development of the international monetary system.”

China has left the rest of the world in the dust when it comes to digital currencies, although that shouldn’t come as much of a surprise given the way the government and domestic companies — like e-commerce giant Alibaba Group Holding Ltd. and its fintech affiliate Ant Group Co. Ltd. — have used digital technology to transform a backward banking and financial architecture into a cutting-edge, online-focused and user-friendly system for the internet age.

A survey of 66 major central banks carried out by the Bank for International Settlements (BIS) toward the end of 2019 showed that 80% were engaged in some form of CBDC work, up from 70% in the previous survey in 2018. Of the 80%, only 10% had gone as far as developing pilot projects and all of them were in emerging market economies. Some 40% of those doing CBDC work said they had progressed from conceptual research to experiments, or proofs-of-concept, where they had carried out feasibility tests to verify whether the currency had practical potential.

That change has been partly prompted by the rise of cryptocurrencies such as Bitcoin, and by Facebook Inc.’s announcement in June 2019 that it was working on a project to launch a global blockchain-based digital currency, Libra. Although the social media giant’s proposal has since been watered down to a more run-of-the-mill payment system, it focused the minds of officials at national and international level on the future of money — how it’s spent and transmitted, how it’s regulated and how to control the risks stemming from cryptocurrencies including stablecoins and other digital payment systems.

Research into digital currencies has taken on added momentum in the wake of the Covid-19 pandemic, which led to an acceleration in the use of digital payments, fuelling concern that hundreds of millions of consumers, especially the elderly and the “unbanked” — those without access to banking facilities — will be shut out of the financial system. The proportion of contactless payments in global card transactions increased to more than 33% in March when the pandemic raged around the world, up from around 27% six months earlier, according to the BIS.

The year 2020 “has been a watershed moment in the attitudes of many central banks around the world towards CBDC,” Benoît Cœuré, a member of the BIS’s Executive Committee, told Caixin in an interview in October. While Libra has accelerated central banks’ move toward CBDCs, it is technological innovation that is fundamentally driving the change, he said earlier in June.

The Bank of Japan, in its October paper “The Bank of Japan’s Approach to Central Bank Digital Currency,” said it would start testing the basic functions of CBDC as a payment system in 2021. The same month, the European Central Bank published a report on the possible issuance of a digital euro and said that it would decide whether to launch a digital euro...
project toward the middle of 2021.

The U.S. Federal Reserve has been more circumspect. When the BIS approached other major central banks about setting up a group to study digital currencies, the Fed initially declined to get involved, a senior central banker close to the group told Caixin. But after the group was formally launched in January 2020, the Fed subsequently changed its mind and joined the six other founding central banks, which included the Bank of England and the European Central Bank. Its name appeared on the first report issued by the group in October discussing the common principles and key features a CBDC and its supporting infrastructure should have.

The Fed’s chairman, Jerome Powell, said it was more important for the U.S. to “get it right than it is to be the first.”

Over the past years, Chinese central bank officials have attempted to clear up confusion and misunderstanding about the DCEP, how it fits in to the country’s monetary policy and system, how it changes the role of dominant third-party payment systems Alipay and WeChat Pay, and how China’s approach to its digital currency differs from other countries. Those efforts have coincided with the rollout of testing of the currency in retail settings in three cities — Shenzhen, Suzhou and Chengdu — and the Xiongan New Area, a development hub for the Beijing-Tianjin-Hebei economic triangle.

Mu Changchun (穆长春), the head of the PBOC’s digital currency research institute, and Fan Yifei (范一飞), the central bank’s deputy governor, have spearheaded those efforts, giving speeches and writing commentaries to explain the rationale behind the DCEP. Their message is that issuing a sovereign digital currency will maintain the PBOC’s control over the financial sector and monetary system, neuter the threat posed by Libra and other cryptocurrencies, provide a backstop to the existing mobile payment infrastructure, which has become systemically important; promote financial inclusion by making electronic payments more accessible to people without bank accounts; and combat money laundering, financial fraud, and terrorism financing.

Mu has repeatedly emphasized that DCEP is a replacement for cash and will be centrally controlled by the PBOC. The technology behind the currency will enable people to send and receive funds by touching each other’s phones regardless of whether or not they are connected to the internet, a feature Mu says is a clear advantage over Alipay and WeChat Pay.

China’s focus in developing DCEP has been on domestic use by consumers for retail payments rather than on “wholesale” use related to settlement and payment between institutions in financial markets or for cross-border payments, with the aim of making them more efficient and transparent, and easier to supervise. That’s partly because China has a huge informal economy which is driven by cash payments and breaking the cycle will help the government control corruption, illegal cash flows and tax avoidance among other things.

But longer term, as China’s financial system becomes more developed, the DCEP would be conducive to the internationalization of the yuan, Mu said in a speech in 2019.

That’s one key reason why China is pushing hard for common global standards for digital currencies and for increased coordination among international financial authorities to regulate them. The PBOC has already been contributing to work on standards. A paper published by the central bank’s digital currency research institute in 2019 noted that China was the first to add digital currency-related content to the repository for ISO 20022, a new global standard covering financial information transferred between financial institutions that includes payment transactions, securities trading and settlement information, and credit and debit card information.

The paper’s authors said China’s efforts to fill the gap have not only expanded the scope of the application of the new ISO 20022 standard, but also helped promote the internationalization of China’s digital currency standards and improved China’s international influence in the digital currency field.

A source close to BIS told Caixin that broader coordination between central banks in this area is very important, so that in the future, the digital currencies of different central banks can be transferred across borders. “It is like establishing a unified communication technology standard, it doesn’t matter if you’re using a Samsung, Huawei or Apple mobile phone, you can still talk to each other.”

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**China Races to Catch Money Launderers**

Rapid evolution of financial criminality has left a 13-year-old anti-money laundering statute in the dust, forcing authorities to press for tougher, more effective rules and penalties.

By Peng Qinmin and Denise Jia

Chinese authorities are getting more serious about fighting money laundering, or the illegal hiding of the origins of money obtained through criminal activities.

Regulators got a wake-up call in 2019 when the international Financial Action Task Force (FATF) on money laundering highlighted flaws in China’s system. Later that year, several Chinese lawmakers submitted proposals to amend the nation’s 13-year-old anti-money laundering law to catch up with the rapid evolution of financial criminality.

In a video address to a virtual meeting in June of the FATF, a global money laundering and terrorist financing watchdog, People’s Bank of China (PBOC) Governor Yi Gang said China was revising its anti-money laundering law to broaden the scope of supervision, enhance its effectiveness and increase the severity of penalties.

If not for the Covid-19 pandemic, the top-level international conference on anti-money laundering would have been held in Suzhou in the first time for China to host a plenary meeting of the organization. The FATF was founded in 1989 on the initiative of the G-7, the Group of Seven leading industrialized nations, to develop policies and set standards to fight money laundering. China joined the intergovernmental organization in 2007, the same year the country enacted its first anti-money laundering law.

Money laundering, so-called after Chicago gangster Al Capone’s practice of legitimizing criminal proceeds by running the funds through cash-only laundromats in the 1920s, is a huge and growing problem. The estimated volume of money laundered globally every year accounts for as much as 5% of global GDP, or $2 trillion, according to the United Nations.
Office on Drugs and Crime.

In the past year or two, China’s anti-money laundering efforts have drawn increasing attention in international financial circles. The PBOC has been ramping up punishment of financial institutions that fail to adequately guard against money laundering.

In the first six months of 2020, the PBOC doled out penalties of more than 370 million yuan ($53.89 million) for money laundering violations, exceeding the total for all of 2019, data from the central bank showed.

The significant increase in fines reflects a revision in the way the central bank calculates punishment of financial institutions that fail to effectively guard against money laundering. Such institutions would previously receive only one fine at a time regardless of how many rules they broke. Now multiple penalties are imposed for multiple violations. The largest single fine the central bank imposed exceeded 100 million yuan.

“We increasingly realize that anti-money laundering is an important part of national governance,” said Wu Xiangjiang, the head of Industrial and Commercial Bank of China’s internal control department. “In the process of internationalization, we also recognize that strengthened anti-money laundering regulation is the consensus of global governance.”

**Updated standards are required**

Rapid developments in financial information, technology and communication allow money to move anywhere in the world with speed and facility, making it easier to hide the true sources of funds from criminal activities. This also makes the task of combating money laundering harder and more urgent than ever.

But with the evolving means of money laundering, China’s law enforcement has been unable to keep up with international standards. Among shortcomings of China’s current statute, lawmakers proposing amendments said, is that limitations on the definition of upstream money laundering cannot meet the practical needs of combating crimes. In addition, they argued, the severity of punishment is relatively lenient, the scope of punishment is relatively narrow and anti-money laundering efforts fail to reflect proactive “risk-based” principles.

According to a work report of the Standing Committee of the National People’s Congress released May 25, the amendment of the anti-money laundering law has been placed on 2020’s legislative agenda.

**Scope needs to be expanded**

One key change will be expanding the definition of criminal money laundering. For example, illegal informal banking networks are often used in money laundering, but cases involving such underground lenders are mostly prosecuted as “crimes of illegal business operation” rather than money laundering. The sentencing is relatively lenient relative to the damage these illegal lenders cause to society, said Yang Xiaoping, a former governor of the PBOC’s Kunming branch.

In addition to underground lenders, pyramid sales schemes and gambling are also often related to money laundering, but those crimes are rarely prosecuted as money laundering.

In 2018, courts across the country concluded 4,825 cases involving money laundering, in which 11,428 individuals received sentences. Among them, however, only 47 cases were specifically identified as money laundering, involving 52 people who were sentenced.

The FATF raised the issue of too few sentences for money laundering in its fourth round of anti-money laundering evaluation of China in February 2019.

“The FATF considers it inconceivable that China, the world’s second-largest economy, has only a few dozen ‘money laundering’ convictions a year,” a person close to the assessment told Caixin.

Another factor that contributes to the low numbers of money laundering convictions is that China’s criminal law does not allow the prosecution of money laundering for one’s own personal benefit.

“If a corrupt official launders his own bribery money by transferring and hiding it, this is not considered money laundering under current law,” a senior anti-money laundering regulator said.

While expanding the definition of money laundering in the revised law, the purpose of anti-money laundering efforts will be expanding from just combating crimes to preventing and curbing money laundering-related activities.

“A lot of behaviors may not qualify as crimes, such as individuals leasing or selling their identifications or accounts to other people, which could facilitate money laundering,” a person close to the work on amending the statute said. The revised law would consider making these activities illegal, the person said.

Current law requires that financial institutions as well as certain nonfinancial institutions fulfill anti-money laundering obligations as the financial system is no longer the only channel for money.
laundering. For example, real estate, precious metals and other nonfinancial industries are often used to conceal and launder money. However, China’s anti-money laundering work mainly targets financial institutions, while nonfinancial institutions have never formally done anything to prevent money laundering.

The FATF’s evaluation also pointed out that China’s anti-money laundering supervisory system was almost exclusively focused on the financial sector while there were no effective preventive or supervisory measures covering the nonfinancial sector.

“The PBOC’s level of understanding of risk in the nonfinancial sector is low, as little work has been done in this sector,” the evaluation found.

Money laundering has a high correlation with cash transactions. Banks and other financial institutions in China are required to report all domestic and overseas cash transactions of more than 50,000 yuan. But to avoid scrutiny of large-sum transactions, money launderers often split transactions into 49,900 yuan units.

Switch to risk-based approach

Most financial institutions in China are familiar with their anti-money laundering compliance obligations, but they often do not understand the money laundering risks they face, the FATF evaluation said.

“The risks of money laundering are different for different types of financial institutions operating in different regions,” said Yu Pei, partner of the Deloitte China Anti-Money Laundering Center. “However, domestic banks have not yet made a good risk assessment of themselves and do not know where they are exposed to money laundering risk. They just mechanically complete their compliance obligations but fail to implement more targeted risk-control measures.”

In February 2012, the FATF published its updated standards on combating money laundering, recommending a risk-based anti-money laundering principle. This requires financial institutions to assess the risks associated with illicit activities such as money laundering and terrorist financing and then reasonably deploy corresponding resources in response to the risks.

The revision of China’s anti-money laundering law will consider adoption of such a risk-based principle and require related parties to carry out money laundering risk assessments, allocate regulatory resources according to the risk and impose prevention and control measures.

A senior Chinese anti-money laundering regulator held up rampant cross-border telecommunication fraud as an example. In the compliance-based approach, a responsible institution is considered to have fulfilled its obligation by reporting suspicious transactions, but there is nothing it can do if the criminals withdraw fraudulent funds abroad.

However, under the risk-based principle, the responsible institution in addition to reporting suspicious transactions should immediately take reasonable risk control measures, such as restricting related accounts and suspending online banking or overseas cash withdrawals, the regulator said.

For Chinese financial institutions that are used to a “check-the-box” compliance approach, switching to a proactive risk-based principle will be a big challenge. If banks are required to include all transactions of clients in anti-money laundering monitoring, it will be too much work, said an anti-money laundering official at a city commercial bank.

“If customers have to wait longer for the service, they may be gone,” the official said.

FINANCE

Anbang Salvage Runs Aground

Company created to take over a significant portion of the conglomerate’s assets has failed to complete its restructuring on time

By Hu Yue, Wu Yujian and Guo Yingzhe

Anbang Insurance Group Co. Ltd. has been dismantled and has decided to go into liquidation, but the story of the once high-flying conglomerate remains far from over.

Dajia Insurance Group Co. Ltd., the company created to take over a significant portion of Anbang’s assets, has failed to complete its restructuring plan by its initial August deadline amid disagreements among regulators and stakeholders as well as disputes over some of Anbang’s overseas assets, knowledgeable sources told Caixin.

Regulators and stakeholders of Dajia have already agreed to an overhaul of the restructuring plan, the sources said. China Insurance Security Fund Co. Ltd., Dajia’s largest shareholder, would finish reevaluating the company’s assets by the end of 2020, and would restart wooing strategic investors in 2021, they said. Insurance Security Fund operates the insurance protection fund that raises money through mandatory contributions from insurance companies based on their premium income.

The faltering salvage operation raises questions about how easily the insurance protection fund will be able to recover the 60.8 billion yuan ($9 billion) that it injected into Anbang after it was seized by the government in 2018. It also raises doubts about China’s corporate turnaround campaign to defuse the risks to the financial system spawned by not just Anbang, but other freewheeling conglomerates like CEFC China Energy Co. Ltd. and Tomorrow Holding Co. Ltd., particularly amid the economic changes brought about by the coronavirus pandemic.

Getting the fund’s money back

The chief goal of the restructuring plan is to ensure Insurance Security Fund avoids taking a bath on its investment, the sources said. Financial regulators have decreed that the fund firm can only hold Dajia equity temporarily, with an end goal of Dajia emerging from restructuring as a privately owned company.

Regulators initially intended for Dajia to have a decentralized stake structure consisting of three to five new qualified investors — the goal was to prevent a single large shareholder from abusing its position, the sources said. However, they found it difficult to attract enough quality investors and eventually decided not to stick to the decentralized equity plan. Nonetheless, recouping as much of Insurance Security Fund’s money as possible remains the primary goal, they said.

The 60.8 billion yuan was used to
plug the hole in Anbang’s capital that its founder Wu Xiaohui had left by falsifying capital injections. Wu was sentenced to 18 years in prison for fundraising fraud and embezzlement in May 2018.

At the end of June 2018, Anbang recorded negative 130 billion yuan in net assets, including a paper loss on its investment in China Minsheng Banking Corp. Ltd.

One reason behind the restructuring plan’s failure was that some of Dajia’s assets had lost value amid the pandemic, causing hand-wringing among regulatory officials about the possible loss of the insurance protection fund, according to people familiar with the matter.

According to the previous restructuring plan that was made around the end of June, Primavera Capital Ltd. and Xiamen International Financial Technology Co. Ltd. were set to buy about 32% of Dajia’s stake for 1.5 yuan per share, and Insurance Security Fund’s holding would be reduced to 63%, the people said.

However, under the plan, the fund firm would have to tolerate a paper loss in the billions of yuan until Dajia’s share valuation recovered to the point where it could sell off its stake without losing money, which is 2.5 yuan per share, the people said.

Much of that paper loss has something to do with Anbang’s investment in Minsheng. In recent years, Anbang bought a large number of shares of the Shanghai- and Hong Kong-listed bank, eventually sinking 90 billion yuan into the stock, according to Caixin calculations based on data from Minsheng’s exchange filings. The majority of Anbang’s stake in Minsheng has been transferred onto Dajia’s balance sheet. Currently, the bank’s sluggish share price leaves Dajia 50 billion yuan in the hole on the investment.

As to Dajia’s other assets, some have gained in value just as others have declined amid the pandemic, the sources said. Although its total assets need to be reassessed, Dajia could have a net asset value as high as 20 billion yuan, without taking into account the Minsheng investment.

Joining Dajia’s restructuring in 2021 still interests some companies, including Primavera Capital and some listed Chinese insurers, the sources said, as some Dajia assets remain attractive to them. Foreign insurers can also partner with Primavera Capital in investing in Dajia, they said.

**Lawsuits overseas**

Dajia also faces uncertainties in its disposal of some of the assets Anbang accumulated during its unbridled overseas spending spree in the 2010s, such as luxury U.S. hotels. Dajia has set aside hundreds of millions of U.S. dollars to deal with these uncertainties, the sources said.

After regulators took over Anbang, they decided to sell its overseas assets that did not do much to augment its core insurance business. One snag in this plan is a dispute between an Anbang subsidiary and a company owned by South Korean investment firm Mirae Asset Global Investments Co. Ltd. over Anbang’s Strategic Hotels & Resorts Inc.

In September 2019, Mirae’s MAPS Hotel and Resorts One LLC agreed to pay $5.8 billion to buy Strategic Hotels from the Anbang subsidiary, AB Stable VIII LLC. The deal included 15 hotels in the U.S. But MAPS tried to back out of the deal in 2020 due to the decline in the hotels’ value and its rising financing costs amid fallout from the pandemic, using Dajia’s delayed disclosure of disputes over the ownership of the hotels as an excuse, the sources said. In April, AB Stable filed a lawsuit against MAPS in the U.S. to force it to honor the deal.

The disputes over the hotels’ ownership were stirred up by a person named Andy Bang living in California. He claimed that four of his companies owned the hotels based on a contract he had signed with Wu and Chen Xiaolu, a former Anbang director. In 2019, the four companies filed lawsuits in the U.S. demanding to be compensated by Anbang and Dajia.

However, private detectives hired by Dajia later found out that the companies were incident-faking extortionists, and judicial authentication showed that the contract was fake and Wu and Chen’s signatures on it were forged, the sources said. Several U.S. courts eventually dismissed related lawsuits.

As of the end of August, Anbang’s overseas investment totaled about 130 billion yuan, and Dajia had recouped about 80 billion yuan by selling off assets, the sources said. That disposal will be nearly complete once it offloads Strategic Hotels, they said.
Investment Firm Turns on Money Man

China Minsheng Investment Group levels financial misconduct accusations against the CEO of an investment bank it has backed for years

By Wei Yiyang, Wang Duan, Wu Hongyuran and Luo Meihan

Embattled private investment conglomerate China Minsheng Investment Group Corp. Ltd. (CMIG) has turned against its former partner Calvin Choi, chairman and CEO of Hong Kong-based financial services provider AMTD Group Co. Ltd., accusing Choi of financial fraud, as the debt-ridden investment firm struggles to pay off its debts.

The scandal comes as AMTD Group, whose listed subsidiary calls itself the No. 1 independent investment bank and asset manager in Asia, continues to expand. Since Choi took over in February 2016, AMTD Group has transformed itself from a small mortgage lender into a financial conglomerate with businesses ranging from investment banking and asset management to insurance brokerage and equity investment.

Following its subsidiary AMTD International Inc.’s IPO in New York in 2019 and second listing in Singapore in 2020, the group was planning to list its fintech business in Hong Kong in 2020, Choi told a Hong Kong newspaper in April.

Before heading AMTD Group, 42-year-old Choi worked at Citigroup, PricewaterhouseCoopers Hong Kong and UBS AG. At UBS, He worked hard and was demanding — sometimes willing to take compliance risks to achieve goals, one of his former colleagues told Caixin, who spoke highly of his competency.

Choi got to know Dong Wenbiao, then chairman of China Minsheng Banking Corp. Ltd. and founder of CMIG, when he participated in one of the lender’s financing projects years ago, people with knowledge of the matter said. The pair later developed an extraordinary and close business relationship, especially when Choi worked for UBS, where he most recently served as managing director of its investment bank division, multiple financial industry insiders said.

Debt collection

Cofounded in 2003 by CK Hutchison Holdings Ltd., a Hong Kong-listed company owned by billionaire Li Ka-shing, AMTD Group was later controlled by a subsidiary of U.S. investment bank Morgan Stanley until 2015.

In 2015, AMTD Group brought in CMIG, one of China’s largest private investment firms, and L.R. Capital Management Co. (Cayman) Ltd. as major shareholders, who bought a combined 71% stake, according to an AMTD Group bond prospectus from March 2016. Choi’s parents held stakes in L.R. Capital and a related company in 2015, according to Bloomberg News.

AMTD Group said in the filing that the growth of its investment banking business would hinge partly on its ability to take advantage of the relationships and businesses of CMIG and L.R. Capital.

The rapid expansion of AMTD Group was largely backed by CMIG, knowledgeable sources told Caixin.

CMIG entrusted the company with billions of yuan intended for investments, but didn’t get much of it back, they said.

“Some projects (with entrusted money from CMIG) actually made money, but he didn’t give us the profits. Some had losses, but we don’t know whether he truly invested or misappropriated the money,” a CMIG senior executive said.

CMIG has been trying to get its money back from Choi since 2018, the year Dong stepped down as CMIG chair, company insiders told Caixin. Company management vowed to “send Choi to jail” if he failed to return its funds, an insider said.

In August, after CMIG publicly accused Choi in Hong Kong of defaulting on his repayments, Choi released a statement that didn’t directly address CMIG accusations.

At one point, Choi owed CMIG about 3 billion yuan ($447 million), though he has since paid back 700 million yuan, the company senior executive recently told Caixin.

The two sides’ breakup came in the context of a CMIG liquidity crunch driven largely by its overseas investment failures and poor management.

Founded in 2014, CMIG racked up much of its debt during a subsequent spending spree, typically from its international investment arm, CM International Capital Ltd., which took
some bad bets on several Hong Kong-listed companies, people familiar with the matter said.

CM International Capital, specializing in international investment, is considered to be CMIG’s most corrupt and chaotically managed unit, whose total losses over its lifetime are estimated to be at least 10 billion yuan, the people said. With $2.2 billion in registered capital, the company squandered all of its net assets in a few years, failing even to make it clear how the losses occurred, a former CMIG employee said.

In 2019, CMIG defaulted on a series of yuan- and dollar-denominated bonds, with a number of employees also hollowing out its assets, the people said. To shore up its balance sheet, CMIG began asking debtors, including Choi, for its money back.

Money game
After bringing in CMIG and L.R. Capital as shareholders in 2015, AMTD Group started to develop its investment banking business, including underwriting equity and bond issuances for Chinese mainland companies who were eager to raise money in Hong Kong, but didn’t have much appeal to overseas investors.

AMTD Group specializes in raising funds for small and midsize mainland banks to list in Hong Kong, multiple industry insiders said.

To help explain things, an industry insider gave a hypothetical example of a small mainland bank launching an IPO in Hong Kong that is undersubscribed by 200 million yuan. In such a case, AMTD Group would serve as an intermediary to help find financial institutions and local consortiums that can lend 200 million yuan to a company, who then invests in the IPO in exchange for a stake in the bank, the person said. After the listing, the company can use the stake as collateral to borrow money from another bank.

AMTD Group’s rapid growth indicates that it may be engaging in the kinds of business that large institutions turn their noses up at — such as buying up stocks that no one wants and then thinking up ways to sell them, a Hong Kong investment banker told Caixin.

Meanwhile, AMTD Group has expanded its asset management business through IPO services, such as by asking clients to invest part of their IPO proceeds in its asset management products, the investment banker said. The funds, which often get locked up for several years, can be invested in other IPOs, thus expanding the scale of assets under the company’s management, he said.

Choi once acknowledged that the company had managed some of several Hong Kong-listed mainland banks’ IPO proceeds. Coincidentally, AMTD Group said in the 2016 filing that it scored a role managing a $300 million investment portfolio for Bank of Qingdao Co. Ltd. as a result of a “relationship” it developed with the mainland bank after facilitating the lender’s Hong Kong IPO in late 2015.

A spokesperson for Bank of Qingdao told Caixin on Friday that all funds raised from its Hong Kong IPO had been transferred to the mainland as required by the State Administration of Foreign Exchange and were earmarked to replenish its capital — as opposed to being handing over to an outside manager for investment.

In 2017, a related company of L.R. Capital and another investor sold off their stakes in Bank of Qingdao, and then AMTD Group bought roughly the same number of the bank’s shares, according to shareholding records disclosed on the Hong Kong Stock Exchange. Later that year, AMTD Group lent a similar amount of the shares to its controlling shareholder, L.R. Capital, which in turn used them as collateral to obtain loans from an undisclosed third party, according to AMTD International’s 2019 annual report. The shares lent were worth about HK$1.2 billion at the end of 2019.

The third party who issued the loans is Guangzhou Rural Commercial Bank Co. Ltd., according to public records from Bank of Qingdao and the Hong Kong bourse. In 2017, AMTD Group served as the financial advisor and joint global coordinator for the Guangzhou lender’s Hong Kong IPO.

AMTD Group’s investment in Bank of Qingdao not only helped its controlling shareholder secure financing, but also enabled its listed subsidiary to dress up financial statements that would have shown losses.

In 2019, AMTD Group signed a derivative agreement with a company owned by Andrew Chiu — a grandson of Hong Kong tycoon Chiu Te-ken. The income generated from the agreement, which was linked to the stock of Bank of Qingdao, contributed over HK$1 billion of AMTD International’s profit in 2019. Andrew Chiu holds a stake in AMTD International, where he serves as a vice chairman.
While it has always claimed that its investment in Bank of Qingdao is a strategic long-term one, AMTD Group in June sold nearly half of its stake in the bank, according to Hong Kong bourse records. On the same day, Ariana Capital Investment Ltd., another company founded by Andrew Chiu, acquired exactly the same number of the lender’s shares as AMTD Group sold.

Neither AMTD Group nor Ariana explained the sale and purchase. They didn’t disclose whether the trades constituted related-party transactions, either. The spokesperson for Bank of Qingdao said the transactions were merely market actions, and AMTD Group and Ariana had both disclosed the information in a timely manner based on their obligations to the exchange.

China’s top leaders mapped out policies for the country’s economic and social development over the coming five years at a key meeting in October, with President Xi Jinping’s new “dual circulation” strategy taking center stage to help the economy overcome medium- and long-term challenges.

Proposals for the five-year plan (FYP) covering 2021-2025 were discussed at the fifth plenary session of the Communist Party’s 19th Central Committee from Oct. 26 to 29, the highest-level policy-setting event since the outbreak of Covid-19. A broad outline of the plan was published after the gathering but a more detailed menu of policies is not likely to be released for weeks or even months. The plans usually cover almost every economic and social issue and set targets ranging from annual economic growth and urbanization rates to pollution control, education and research and development spending.

Here are some key themes to watch out for in the 14th FYP.

**Dual circulation**

Expect to hear a lot more about some relatively new buzzwords, especially dual circulation, factor market reform and governance, along with older ones such as supply-side structural reform which first emerged in late 2015.

Far more than just buzzwords though, these are serious, well-thought-out strategies and policies to guide China’s economic development through a fundamental structural shift away from speed toward quality and sustainability. Dual circulation and factor market reform emerged last year and will provide a broad framework for government ministries, officials and advisers to design and implement more detailed, specific policies that will help the economy flourish and grow in a sustainable way.

President Xi unveiled the “dual circulation” strategy at a Politburo meeting in May. Although no concrete details of the strategy have been released, broadly speaking, it involves making the economy more reliant on “internal circulation” — the domestic cycle of production, distribution and consumption — while being supported by “external circulation,” which relates to international trade and investment and China’s links with the rest of the world.

Reform of the markets for factors of production — land, labor, capital, technology and data — is needed because the current system is distorting the price and allocation of resources and holding back growth in what’s known as total factor productivity, a key measure of an economy’s productivity, according to Wang Yiming, a former deputy director of the Development Research Center, a think tank under the State Council.

No more GDP growth targets?

The 14th FYP is particularly important for the next stage of China’s economic and social development as 2020 marked the end of the country’s decades-long goal to achieve a “moderately prosperous society (小康社会) in all respects.” This
is a traditional concept dating back to Confucian times to describe a society with a functioning middle class. It has been tweaked and updated over the years and it was fleshed out with concrete goals at the Communist Party’s 18th Congress in November 2012: double gross domestic product (GDP) and per capita income from 2010 to 2020, and eradicate poverty. The targets were set to be achieved just ahead of the 100th anniversary of the founding of the party in 2021.

With the finishing line in sight, the government is now focusing on formulating strategies to cope with new challenges and objectives. Policymakers know the economy faces many headwinds. On the external front these include the ongoing Covid-19 pandemic, worsening relations with the U.S. and the prospect of technology and supply chain decoupling. On the domestic front they include cleaning up the environment, upgrading China’s industrial structure, shifting to a consumption-driven growth model, boosting incomes and reducing wealth disparity, and coping with a declining labor force and an aging population.

It’s widely expected that the 14th FYP will play down GDP expansion as a major target and focus more on the quality of growth, a recognition that the economy is undergoing a structural slowdown and that speed is no longer the most important factor in economic development.

China’s annual average GDP growth rate has slowed from 9.8% over the 2001 to 2005 period just after the country joined the World Trade Organization to an average of 6.7% over the first four years of the FYP that ended in 2020. Economists widely expect that over the 2021 to 2025 period of the 14th FYP, the pace will fall even further, to a range of 5% to 5.5%.

The GDP targets in the FYPs have bowed to the inevitable — the annual average target in the last plan was set at “at least 6.5%,” down from 7% in the 12th plan that ran from 2011 to 2015. There has been considerable debate about what an appropriate target rate should be for the next FYP and whether the GDP growth goal has outlived its purpose and should be scrapped altogether.

The pre-eminence of the GDP target, which historically policymakers deemed necessary to ensure full employment, meant that local governments focused on boosting investment, the easiest way to achieve short-term growth.

Based on past experience, continued focus on the pace of growth, especially if the target is set too high, will drive local governments to strive to meet or exceed it. That could lead to unnecessary stimulus policies that will have side effects that include a further buildup of debt and leverage, excess capacity and asset bubbles, Xu Lin, a former director of the National Development and Reform Commission’s development planning department, wrote in an article in May.

Wang Tao, the head of Asia economics and chief China economist at UBS Investment Bank, expects China’s GDP growth to average only 5% in the next five years, weighed down by a series of factors including shifts in global supply chains fueled by tougher U.S. policies on the use of Chinese technology and growing pushback against globalization. On the domestic front, China will be challenged by aging demographics, elevated macro leverage, technology bottlenecks, and low efficiency in some areas of the economy.

Wang said she expects the government to either not set an explicit growth target or put forward a lower and more flexible range of around 5%.

Li Chao, chief economist at Zheshang Securities Co. Ltd., said the government should scrap the target altogether and put more emphasis on the quality and structure of economic growth. He proposed alternative goals such as the proportion of value-added output from strategic emerging industries as a percentage of GDP, the rate of urbanization, direct financing as a percentage of total social financing, or the market capitalization of China’s stock market as a percentage of GDP. The goals would serve as indicators to allow the government to track the performance of core supply-side factors, including the productivity of labor and capital, Li said.

More focus on consumption
China has for many years emphasized the importance of increasing domestic demand, especially after the 2008-2009 global financial crisis. But the focus was placed on infrastructure and property investment with far less support for household consumption, which is a more long-term and complex issue to tackle.

But now, many local governments have complained they are running out of good infrastructure projects to carry out, financing is becoming more difficult to find and the central government has imposed more stringent controls on local government financing vehicles.

A shoe production workshop in Wenzhou, Zhejiang province, Sept. 19. Photo: Liang Yingfei/Caixin
Concerns over price bubbles in the housing market have led to a campaign to rein in the sector that’s now lasted more than three years and shows no signs of being relaxed. As a result, increasing domestic consumption, especially private consumption—goods and services bought and consumed by households—needs to be at the forefront of the dual circulation strategy, economists say.

Private consumption as a share of GDP still lags far behind that of developed countries, although that does give China plenty of room for improvement. The latest data from the Organization for Economic Development Cooperation (OECD) show that in China, household spending as a percentage of GDP is 38.5%, compared with an average of 60% for OECD economies, 64.5% in Brazil and 67.9% in the U.S.

Catching up will involve a whole host of policies involving taxation and the fiscal system to narrow the gap between rich and poor, redistribute income away from companies toward private consumers, increase household income and give households a greater share of national income.

The government is already taking steps down this path—in 2018, for example, the government announced an overhaul of the personal income-tax system that the cut burdens on almost 60% of taxpayers, according to Gan Li, a professor at the Research Institute of Economics and Management at Southwestern University of Finance and Economics.

But economists generally agree that much more needs to be done and the 14th FYP could well include new reforms, policies and measures to help drive household consumption. Li Shi, a professor at Zhejiang University, said the government should accelerate reform of the income distribution system, further improve the social security system and enhance government transfer payments to poor people.

One way to create demand, especially for services, is to expand the middle class, which is currently estimated at around 400 million people. The government should aim to double the size of this cohort to 800 million to 900 million, or about 60% of China’s total population, over the next 10 to 15 years, according to Liu Shijin, vice chairman of the China Development Research Foundation, a government-sponsored think tank.

**Technology self-sufficiency**

China has for years implemented various strategies to promote the country’s shift up the industrial value chain and bolster its position in high-tech and other emerging sectors, notably through the Made in China 2025 initiative and the mass entrepreneurship and innovation campaign. But the drive has taken on added urgency as tensions with the U.S. have deepened and the threat of a technological decoupling rises as America imposes more and more restrictions on the sale of high-tech components to Chinese companies.

President Xi has continuously emphasized the need for self-sufficiency in key technologies, and at an August symposium to solicit input for the 14th FYP from economists and scholars, he said technology and innovation can foster new growth drivers and are key to building “internal circulation.” His remarks reaffirm expectations that China will double down on its efforts to reduce its reliance on technology from the U.S. and other economies and many analysts expect the 14th FYP to put even greater emphasis on funding for research.

For the past decade, spending on research and development (R&D) as a percentage of GDP in developed countries such as the U.S., South Korea and Japan has been two to four times the rate in China, according to Li, the economist at Zheshang Securities. Although R&D spending to GDP has been a target in every FYP since the 10th plan covering 2001-2005, the country has never achieved the figure set by the government, official data show. In 2019, China’s R&D spending to GDP ratio was 2.2%, below the 2.5% target for 2020.

Wang from UBS said she expects R&D spending to around 3% in 2025. That would support spending on basic research and cutting-edge technologies in areas such as semiconductors, software, precision machinery and advanced robot technology, as well as to strengthen intellectual property rights protection, she said.

**FINANCE**

**What’s Next for the Yuan?**

Chinese currency may still have legs after 8.5% gain against greenback since end-May, analysts say

**By Peng Qin Qin and Guo Yingzhe**

Notwithstanding growing tensions between Washington and Beijing and the Covid-19 pandemic, now is a good time for Chinese mainland tourists to hop on a plane to the U.S.—the appreciation of the yuan over the past months means they are getting far more bang for their buck.

At the end of May, they needed to exchange 7,146 yuan to get $1,000, but on Dec. 14 they would only have had to part with 6,537 yuan, a saving of 609 yuan, or 8.5%, according to the central bank’s official closing price. The yuan has been the second-best performer against the U.S. dollar among Asian currencies since it hit a closing low of 7.16 yuan on May 28, beaten only by the South Korean won.

The Chinese currency’s rapid appreciation over the past months to its strongest level against the dollar in nearly two and a half years has raised concerns among some analysts that it has strengthened too quickly and could have an adverse impact on exports—in an analysis of November’s official manufacturing Purchasing Managers Index, the National Bureau of Statistics noted that 18.8% of export companies said they were affected by fluctuations in the exchange rate, up from 17.1% in October, and some survey respondents said appreciation had put corporate profits under pressure and led to a decline.
in export orders.

Even so, some analysts say Chinese policymakers’ tolerance for appreciation is set to continue.

“Comments from senior officials … suggest that appreciation is currently looked at favorably in Beijing, since it makes yuan-denominated assets look ‘competitive’ internationally,” Louis Kuijs, Hong Kong-based head of Asia economics at research firm Oxford Economics Ltd., told Caixin. “Barring drastic FX (foreign-exchange) pressure, I expect the authorities to maintain this stance in 2021.”

Kuijs said he expected the yuan to be trading at 6.6 per dollar at the end of 2020 and saw further appreciation to 6.5 by the end of 2021, although he expected to see “significant exchange-rate fluctuations over and above the underlying trend, consistent with the direction of reform.”

London-based research firm Capital Economics Ltd. sees even stronger gains, estimating the yuan will appreciate to 6.2 per dollar by the end of 2021, partly because of a persistently large gap between yields on Chinese government bonds (CGBs) and U.S. government bonds, which will attract overseas demand. CGBs offer a much higher return than U.S. Treasuries — the 10-year yield differential has risen by over 200 basis points since the end of 2019, the firm noted in a Dec. 8 research note.

Analysts and participants in the foreign-exchange markets interviewed by Caixin say now is not the time for regulators to step in and halt the appreciation because it is not being driven by speculation but by fundamental factors such as a strong economy, booming exports, and inflows of overseas money investing in China’s capital markets. Instead, policymakers should take advantage of the yuan’s strength to introduce more flexibility into the current exchange-rate formation mechanism and give the markets a bigger role in determining the yuan’s value, as they have been promising for several years.

The People’s Bank of China (PBOC), the central bank, has gradually been introducing more flexibility into the yuan exchange-rate mechanism since the last major round of reform in August 2015, when it shocked global markets by changing the way it calculated the daily reference rate, also known as the fixing, for the currency’s value against the dollar.

The yuan is still only allowed to move by a maximum of 2% either side of the reference rate which is published each trading day at 9:15 a.m. local time, but the fixing is now more volatile and the PBOC allows it to be more market-driven. In October, the central bank scrapped the counter-cyclical factor, a key element of the way it sets the daily reference rate originally introduced in 2017 to stem the yuan’s depreciation. That has given traders more of a say in determining the yuan’s value.

China’s foreign-exchange market has matured since the 2015 reform and the public has increasingly adapted to the more flexible yuan, said Li Liuyang, a forex analyst at China Merchants Bank Co. Ltd. Increased exchange-rate flexibility means that investors and traders can respond more quickly and efficiently to new market information and take new long or short positions based on their changed expectations, Li said.

Financial regulators need to have more tolerance for fluctuations in the exchange rate, said Guan Tao, chief global economist at BOC International (China) Co. Ltd. “We have to believe that in the context of the marketization of exchange rates, the exchange rate will rise and fall — it can’t only rise or only fall. If we never trust the market, we can never go down this road” toward a market-based exchange-rate mechanism, Guan said.

In the past, some spurts of yuan appreciation against the dollar were driven by speculation that the central bank worked hard to stamp out, mostly through starving the offshore yuan market in Hong Kong of liquidity and ordering financial institutions to sell the Chinese currency to satisfy demand. But the current stretch of gains is being fuelled by fundamental factors, analysts say. One driver is the rebound in exports since the depths of the Covid-19 pandemic in the first quarter, a financial regulatory source told Caixin. Appreciation driven by fundamentals is reasonable and if regulators take measures to block it, pressure will only continue to build, the source said.

Although in the past yuan appreciation had a negative impact on overseas sales, the historic correlation between the exchange rate and exports has been disrupted by factors including the Covid-19 pandemic and the U.S.-China trade war, said Zhong Zhengsheng, chief economist at Ping An Securities Co. Ltd. That suggests the yuan’s recent rally will not have a substantial impact on exports until
the pandemic fades, he said.

Another driver is the recovery in economic growth since the historic slump in the first quarter. GDP expansion has picked up speed and was 4.9% year-on-year in the third quarter, boosting the confidence of investors, companies and consumers in the world’s second-biggest economy. The International Monetary Fund now projects 1.9% GDP growth for the full year of 2020, compared with a forecast contraction of 4.4% for the world as a whole. In 2021, the IMF estimates China’s economy will expand 8.2%, way faster than its projection of 5.2% growth for the global economy.

China has steered clear of the massive fiscal stimulus rolled out by most major economies hit by the coronavirus, and avoided implementing an excessively loose monetary policy and slashing interest rates. That’s meant returns on assets in China are higher than those in many other countries which has lured global investors and pushed up demand for the yuan. Global investors are also less keen to hold U.S. dollar assets owing to the economic chaos in the U.S. caused by the spread of the coronavirus and by the lack of a strategy by President Donald Trump’s administration to bring it under control. As of Dec. 14, the U.S. dollar index, which measures the value of the dollar against a basket of currencies of the U.S.’s most significant trading partners, had dropped more than 7.7% since the end of May.

In China, foreign exchange trading is tightly controlled to prevent currency speculation and stabilize the exchange rate. In order to increase the yuan’s flexibility further and give the market more of a say in determining its value, some analysts and market participants say regulators need to ease up on some controls. Currently, when importers or exporters exchange foreign currency through a bank, bank officials have to check documents such as contracts and customs declarations that prove the trading is for real business.

But these controls deny businesses the freedom to buy and sell foreign exchange at will to hedge against currency fluctuations. If traders think the yuan is cheap and want to buy more because they think it’s going to appreciate, they can only buy based on their business’ trading volume and are not allowed to buy more, a source in the foreign exchange market explained to Caixin. Regulators should relax checks on documentation when there is a large fluctuation in the exchange rate so that exporters and importers can buy or sell currency more freely in order to hedge their foreign exchange risks, the source said.

Cross-border capital flows are another key factor affecting the exchange rate and as a result are also subject to strict controls. When capital was pouring into China in the decade through 2014 and the yuan was appreciating, the PBOC was more concerned about controlling inflows, but since 2016, the focus has been on controlling outflows to rein in depreciation pressure on the currency and preserve the country’s foreign exchange reserves.

However, as confidence in China’s economy has improved and the
government has further opened up the capital markets to overseas money, inflows have returned and forex regulators have signaled an easing of restrictions on money leaving China to take some of the heat out of the yuan’s appreciation pressure.

**More quotas**
In September, for example, the State Administration of Foreign Exchange (SAFE) issued $3.4 billion of new quotas for the Qualified Domestic Institutional Investor (QDII) program that allows domestic investment in overseas securities markets. It was the first addition in 22 months and took the total quota issued since the program started in 2006 to $117 billion.

The SAFE is considering further increases in QDII quotas to send a message of openness to the market, sources familiar with the issue have previously told Caixin.

Some analysts argue that investment quotas should not be used to try to influence the exchange rate. If regulators open up immature capital outflow channels as a way of easing yuan appreciation pressure, then once the situation reverses, investors could then use this same channel to take capital out of the country, Guan said. If policies are then changed back, it damages the image of openness the government wants to portray, he said.

The million-dollar question now is: for how much longer can the yuan keep appreciating. Part of the answer lies with the U.S. dollar, the world’s dominant currency and that, in turn, will depend to a great extent on the economic policies of U.S. President-elect Joe Biden. So far, his policy agenda suggests he will implement an expansionary fiscal policy to support the economy through the Covid-19 pandemic and that will keep the dollar weak, many analysts say.

Biden is also widely expected to start repairing relations with its trading partners, which would also benefit other currencies, said Li from China Merchants Bank. That could see the dollar index fall by 4% to 5% from its current level. Under that scenario, the yuan could appreciate by another 2% to 2.5%, Li said.

A broad-based global economic recovery and a mass coronavirus vaccination program could also increase international investors’ appetite for more risky assets, which would favor China and other emerging markets. However, other factors could make markets more risk averse, according to Ping An Securities’ Zhong, who pointed to uncertainty over, or disruption to, the handover of power from the Trump administration to the new president, a resurgence of Covid-19, and a higher global debt burden resulting from the pandemic. That would increase demand for dollar-denominated assets, which are seen as a safe haven in times of trouble, and could spell the end of the yuan’s spectacular run.

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**FINANCE**

**Property Developers Run Into Debt Limits**

Companies that cross debt-related red lines will have their ability to take on more borrowing curtailed

By Wang Jing, Niu Mujiangqu, Timmy Shen and Gavin Cross

China’s property developers are preparing for another bleak winter as the government steps up efforts to control debt and risks in a sector that’s become an increasing concern for policymakers.

Regulators have tested a new financing directive on 12 top real estate firms that will limit their ability to take on more borrowing, according to sources who took part in a meeting between the People’s Bank of China, the Ministry of Housing and Urban-Rural Development, property firms and other government bodies on Aug. 20 in Beijing. Developers subject to the trial include China Evergrande Group, Sunac China Holdings Ltd. and Country Garden Holding Co. Ltd.

The ability of companies in the pilot to increase their debt is subject to three red lines: a liability-to-asset ratio (excluding presales) of no more than 70%; a net debt-to-equity ratio of under 100%; and cash holdings at least equal to short-term debt, according to information circulated online that Caixin has confirmed with sources.

Developers that do not overstep any of the three red lines will be able to increase their annual interest-bearing liabilities by up to 15%, while those that cross one or two red lines are allowed an increase of 10% and 5%, respectively. Companies that step over all three red lines will be banned from taking on more debt.

Executives from the 12 companies who attended the Aug. 20 meeting...
Property Developers Face Fresh Financing Limits

Y = Maximum permitted annual growth in debt

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<th>Liability to asset ratio (excluding presales) of ≤ 70%</th>
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<td>Yellow (one red line crossed, Y = 10%)</td>
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Sources: Ping An Securities, public information compiled by Caixin

“Property Developers Face Fresh Financing Limits”

Li. were notified verbally that they had been selected for the pilot and gave their feedback, according to one source who was present. The documentation detailing the trial was handed out to the executives at the end of the meeting.

China’s government started a crackdown on real estate speculation about four years ago after prices of residential property surged, raising concerns a bubble was building that could exacerbate risks in the financial system. Policymakers have repeatedly stressed that “houses are for living, not for speculation,” but although property was one of the few sectors not to benefit from post-coronavirus stimulus policies, the market is growing red hot again in many parts of the country.

The new borrowing directive is the latest attempt to exert control over real estate financing, a policy that’s been in effect with varying degrees of severity and success over the past few years. Regulators issued a slew of measures in 2019 to curb excessive borrowing by property developers — the banking and insurance regulator instructed banks to carefully screen developers’ qualifications when issuing loans and restrained trust companies from providing new financing to real estate companies.

One of the biggest costs incurred by developers is the purchase of land-use rights from local governments to build new homes, and although transactions slumped in early 2020 due to the Covid-19 epidemic, business has been picking up again as local authorities scramble to raise cash.

“This is a clear signal from the regulators, which could lead some real estate firms to slow down the pace of land acquisition,” one source at a major property developer said, adding that land cost is a big part of the real estate firms’ spending, and reducing the acquisition of land is one of the most effective measures to curb debt.

The 12 developers taking part in the pilot are: China Evergrande, Sunac, Greenland Holdings Corp. Ltd., Zhongliang Holdings Co. Ltd., Sunshine City Group Co. Ltd., Country Garden, China Vanke Co. Ltd., Seazen Holdings Co. Ltd., Poly Real Estate Group Co. Ltd., China Overseas Property Ltd., China Resources Land Ltd. and Shenzhen Overseas Chinese Town Co.

Liu. Data compiled by Caixin show that Evergrande, Sunac, Greenland, and Zhongliang already triggered all three red lines at the end of June.

Country Garden, one of three developers to already cross one red line, has expanded rapidly over the past few years following a strategy of “high leverage, high liabilities, and high turnover.” Wu Bijun, chief financial officer and vice president of Country Garden, said at an Aug. 25 briefing that the company’s financial indicators were “in a good state” and that the new rule would not have a big impact on the management of the business.

While most executives have sounded a positive note in public, saying that the impact of the pilot will be manageable, one senior executive at a midsize Shenzhen property developer told Caixin that if and when the directive is rolled out across the industry, “it could lead to the death of a large number of small and midsize property developers.”

Shao Mingxiao, the CEO of Longfor Group Holdings Ltd., which is not involved in the trial, said at an Aug. 26 briefing that the main intention of the three red lines is to stabilize leverage, curb the growth of developers’ debt and stabilize the housing market. Shao said regulators want real estate developers’ financing to grow in an orderly manner and that the new measures will help to give them better oversight of companies.

Deng Haozhi, a real estate expert based in Guangzhou in South China, said that in effect the new policy puts a hard cap on the growth of real estate companies. It will solidify the positions of the top firms and put state-owned developers at an even greater advantage because they enjoy lower financing costs and are in general more cautious about adding leverage.

“Judging from the experience of the past few years, the financing costs of private enterprises are generally higher than those of state-owned enterprises (SOEs), while among SOEs, those administered by the central government have the lowest financing costs,” Deng said.
China’s antitrust watchdog has rapped the knuckles of three of the nation’s leading private firms, issuing fines over previous acquisitions in the latest signal their transactions are being ever more closely watched.

The State Administration for Market Regulation (SAMR) said it had fined Alibaba Group Holding Ltd. 500,000 yuan ($76,500) for failing to seek approval before increasing its stake in department store chain Intime Retail Group Co. Ltd. to about three-quarters in 2017.

China Literature Ltd., the e-books business spun off by Tencent Holdings Ltd., was also fined over a previous purchase.

Meanwhile, the administration said it’s reviewing the combination of DouYu International Holdings Ltd. with Huya Inc., which could create a Chinese game livestreaming leader akin to Amazon.com Inc.’s Twitch Interactive Inc.

Also put on notice was logistics giant SF Express, after its parcel locker service provider Hive Box was fined 500,000 yuan over its May acquisition of China Post Smart Logistics Technology Co. Ltd. through a share swap. The deal gave Hive Box, which owned 44% of the smart lockers distributed across the country by the end of March, a combined market share of 69% after the acquisition was completed, according to the state-run Xinhua News Agency.

“The illegalities of the cases are relatively clear,” the regulator said in an official, 6,000-character fact sheet posted...
to its website. “The above-mentioned companies have a large influence in the industry, carry out many investments and takeovers, have specialized legal teams and should be familiar with the regulations governing M&A. Their failure to actively declare has a relatively severe impact.”

While acknowledging mergers and acquisitions were an important means for internet firms to develop, the regulator said all companies — domestic and foreign, state-owned and private, and regardless of size and whether they are traditional or tech firms — should realize that China’s Anti-Monopoly Law applies to them.

Alibaba said in a statement that it has made adjustments to comply with the government’s instructions, and Hive Box said that it has “humbly accepted and actively implemented” the requirements stated in the notice. China Literature has been actively working with regulators on compliance, according to its statement.

Tencent did not respond by press time to questions about the investigation into the merger of Huya and Douyu.

Private criticism
Regulators declared their intention to increase scrutiny of China’s largest tech corporations with new anti-monopoly rules last month. In November, Beijing unveiled draft regulations that would establish a framework for curbing anti-competitive behavior such as colluding on sharing sensitive consumer data, alliances that squeeze out smaller rivals and subsidizing services at below cost to eliminate competitors.

Beijing’s heightened scrutiny is spurring fears of a broader crackdown on the country’s largest firms. On Monday, shares in No. 3 internet company Meituan plunged 3.8% after Communist Party newspaper the People’s Daily published an editorial slamming the industry’s preoccupation with areas such as grocery delivery at the expense of real technological innovation.

China’s two largest corporations are also its most acquisitive, using scores of deals to expand into adjacent fields and groom some of the country’s most promising startups. Alibaba had led a $2.6 billion buyout of Intime as part of efforts to develop new business models that combine e-commerce with brick-and-mortar retailing. China Literature agreed in 2018 to buy New Classics Media Corp. for as much as 15.5 billion yuan to expand into filmed content.

The companies had failed to seek approval for the deals, which aren’t deemed anti-competitive, the antitrust regulator said Monday.

End of uncertainty
Monday’s fines mark the first time Chinese internet companies have been penalized under the country’s 12-year-old Anti-Monopoly Law, which holds that all firms must apply for antitrust clearance when making acquisitions that cross a certain threshold set by the regulator.

But at least part of the reason why many large private Chinese firms do not typically do so is because of a long-running lack of clarity over whether variable interest entities (VIEs), the legal structure many Chinese tech firms use, are within the purview of China’s Anti-Monopoly Law.

VIEs, typically based in low-tax jurisdictions like the Cayman Islands, were traditionally used by Chinese businesses like Alibaba and Tencent to allow them to raise funds in the U.S. and skirt Chinese laws that prevent foreigners from owning assets in certain areas.

“It has become common for companies simply not to declare potential transactions over the past few years,” Jiang Huikuang, co-partner of Zhong Lun law firm, told Caixin.

Things seemed to shift at the end of July when the SAMR approved a joint-venture transaction proposed by two VIE-structured companies for the first time since 2012, when Walmart Inc. was cleared to buy into online grocery business Yihaodian. Even though the deal was approved, it was seen by some as a sign that companies with VIE structures may no longer be spared anti-monopoly probes.

In a fact-sheet question which asked whether the fine’s relatively small size would have any deterrent effect, the regulator said it took the approach based on anti-monopoly rules that cite a maximum fine of 500,000 yuan and potential to divest the asset in question. Divestment was a highly disruptive remedy that would only be used in extreme cases, it said.

A draft amendment to the Anti-Monopoly Law published in January would dramatically increase the fine’s upper limit from 500,000 yuan to 10% of the operators’ sales in the previous year.

Jiang said for large internet companies that use the VIE structure, with turnover calculated based on the consolidated amount at the group level, future fines could be astronomical.

BUSINESS & TECH

Speed Bumps to Self-Driving Car Navigation

Vast numbers of satellite base stations are being built as companies rush to develop their own national networks.

By Fang Zuwang and Lu Yutong

Following the government’s call for the rapid development of the self-driving car industry in the next few years, companies are aggressively rolling out the satellite base stations needed for such cars to stay on the road.

State-owned telecom company China Mobile Ltd. began offering precision positioning services in October, after building a network of 4,400 base stations across the country in just four months.

This kind of speed is just what the government seems to be after. In February, the authorities said China should be mass producing autonomous vehicles by 2025.

However, in a scenario that has been repeatedly played out when the government encourages an industry’s growth, the specter of excessive capacity and wasteful construction is looming due to uncoordinated development.

Construction race
While navigation services powered by GPS or China’s homegrown BeiDou satellite network are increasingly ubiquitous, they usually aren’t precise.
China Mobile muscled in on the crowded field this year, rolling out its 4,400 base stations in less than four months, said Yu Chengzhi, a China Mobile departmental vice president. That is an eye-popping pace, with one leading manufacturer of base stations for the mapping industry telling Caixin its annual capacity only amounts to about 1,000.

**Different industries, different needs**

China now has more base stations than the U.S. Data from National Geomatics Center of China show the country had more than 10,000 satellite positioning base stations as of August, with another 12,000 under construction, while the National Geodetic Survey (NGS) says the U.S. has 2,200.

In part, China’s high figure is due to the desire of companies to each operate their own network, rather than collaborating with others or sharing data.

Jiang Weiping, director of Wuhan University’s GNSS Research Center,
said that data confidentiality concerns may lie behind this phenomenon, as well as developers building networks to fit a specific market niche.

Most companies target their services at vehicles, so their stations are built along roads, said Gong Jiaqin, founder of a company that develops agricultural drones for spraying pesticides. “We used to work with a service provider for this kind of positioning product, but it cannot meet our demand,” Gong said. “At that moment we realized we need to have our own.”

China Southern Power Grid, one of the country’s two grid operators, made the same choice. To monitor its infrastructure in remote areas, it aims to build about 800 base stations this year.

**Lack of coordination**

However many companies are actually offering similar services and competing for the same market. For example, Qianxun and Sixents — with about 5,000 base stations between them, more than double the U.S. total — are both devoted to driverless vehicles.

“Having a satellite station network covering the whole nation gives the operator a great premium,” said an industry person.

A government-led coordination mechanism is needed to help developers share base stations with each other, said Jiang, and the authorities need to “reasonably” control the number of stations in the country.

In the U.S., all base station operators share data with the NGS, which then makes it publicly available free of charge. Wang Ruiyao, a director at China’s Ministry of Natural Resources, said at an industry conference on Oct. 22 that guidelines to manage satellite base station construction are being drafted. They will aim to promote the healthy development of station construction and positioning services under the premise of ensuring China’s geographic information security, Wang said. ■
risks stemming from debt-driven growth. Danke, run by New York-listed Phoenix Tree Holdings Ltd., manages 415,000 flats across 13 big cities in China. It was one of the upstarts in China’s long-term rental market, which has boomed since 2015 with government support. Beijing has encouraged the development of the long-term rental market in hopes of serving urbanization and diversifying the country’s white-hot housing market.

Founded in 2015, Danke raised more than $600 million from global investors including Joy Capital, Tiger Fund, China Media Capital and Ant Group, before its $149 million initial public offering on Nasdaq in January.

Danke’s financial stress started to emerge earlier this year as the Covid-19 pandemic cooled the rental market. It quickly escalated after the June detention of Gao Jing, Danke’s founder and CEO. Although the investigation of Gao is said to be unrelated to Danke’s business, the incident slammed the brakes on the company’s fundraising, leading to an immediate collapse of the company’s highly leveraged business model. Angry property owners who failed to collect rental payments from Danke took actions such as cutting off the electricity or water or changing the locks to force out tenants. But tenants said they already paid rent to Danke, many using bank loans arranged by the company, and resisted giving up their apartments.

The clashes escalated in many major cities including Beijing, Shanghai, Shenzhen and Hangzhou. Some disputes spilled into the streets, forcing local authorities to step in.

Danke employees in several cities said the company’s offices have closed and many of the workers haven’t received any payment since October. Some employees are planning to take legal action against the company, one staffer said.

The collapse of Danke and the massive debt disputes stirred concerns over the risks of rental loans arranged under partnerships between lenders and rental platforms. Experts questioned whether WeBank, Danke’s financing partner, did enough due diligence and risk control for loans linked to Danke and whether the bank shouldn’t be held accountable in the disputes.

Last week, WeBank said it would waive interest payments and extend the loan terms for more than 160,000 borrowers linked to Danke at least until the end of 2023. But several Danke renters who borrowed from WeBank for upfront payments said they were not satisfied with the bank’s offer.

Several local governments stepped in to mitigate the social turmoil caused by Danke. Caixin learned that authorities are pushing industry leaders including SoftBank-backed Ziroom and Beijing 5i5j Real Estate Brokerage Co. Ltd. to bail out Danke.

Meanwhile, Danke is discussing a plan with WeBank to convert the debts to equity, people familiar with the matter said. The company is also seeking to raise $150 million to ease its cash crunch, sources said. But no deal has been reached.

### Cash-Strapped Long-Term Rentals Spike in 2020

<table>
<thead>
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<th>Year</th>
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<td>2019</td>
<td>54</td>
</tr>
<tr>
<td>Jan.-Nov., 2020</td>
<td>82</td>
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* Units with cash flow and other major problems
Source: Kerry Properties Ltd.

### Risky growth

The loan partnership with WeBank, which provided the backbone of Danke’s expansion, became the focal point of the controversies.

Under the partnership, when a tenant signs a lease with Danke, the tenant also signs a rental loan contract with WeBank to pay a full year’s rent in advance to Danke. Then the tenant makes monthly loan payments to WeBank. To encourage tenants to take out loans, Danke often offers subsidies to reduce their interest costs.

By the end of 2019, more than 65.9% of Danke’s tenants made rent payments...
Hundreds of renters and property owners gathered outside rental service Danke Apartment’s headquarters in Beijing in November. Photo: VCG

using rental loans, down from 75.8% in 2018 and 91% in 2017, according to the company.

Rental loans, more than 90% of them issued by WeBank, became the main source of cash for Danke. According to a company disclosure, rental loan-backed payments totaled 2.75 billion yuan, accounting for 73.8% of Danke’s total revenue in 2019. That same year, Danke received 980 million yuan of upfront cash payments from tenants.

Chinese regulators have stepped up scrutiny of rental loans since 2018 after several rental platforms went bust. In December 2019, six central government agencies issued guidelines to regulate long-term apartment rental businesses, setting a 30% cap on the share of rental loans in total rent revenues.

People with knowledge of the situation told Caixin that Danke and WeBank worked out a plan under the guidelines, aiming to reduce loan-backed rent payments to 40% by the end of this year and meet the 30% requirement by the end of 2021. But Danke’s business reshuffle plan didn’t go as planned, they said.

The massive sum of loan-backed upfront payments allowed Danke to pool enough money to expand its property reserves, but it also posed great leverage risks as the company’s capital chain is fragile, industry analysts said.

To grab market share, Danke offered higher rents to landlords than it collected from tenants in major cities. A document viewed by Caixin showed the company paid 8,500 yuan to a flat owner in downtown Beijing and sublet the property at 7,850 yuan.

In a letter to company executives during his detention, Danke CEO Gao Jing said Danke needed to maintain rapid growth until it reached the stage of sustainable growth and achieved profitability, enabling the company to cut reliance on outside financing.

“But the pandemic disturbed our plan and led to today’s troubles,” Gao wrote.

According to a company report, the 415,000 flats Danke had in operation as of March 31 was nearly double the number a year ago. The company’s operating costs rose 59% year-on-year to 3.1 billion yuan during the first three months this year, while its net loss continued expanding to 1.2 billion yuan. Danke posted a net loss of 3.15 billion yuan in 2019, compared with losses of 1.37 billion yuan in 2018 and 270 million yuan in 2017.

The last straw was the detention of Gao. Danke said June 18 that Gao was being investigated over previous business dealings that were unrelated to Danke. In his letter, Gao said he was probed for violations by an advertising company where he worked in 2014.

But the incident cut off Danke’s access to equity financing and bank loans, a person close to the company said, a significant blow because of the company’s reliance on financing.

Risk control loopholes

Analysts said the financing partnership between Danke and WeBank has a significant hole in risk control. In practice, renters sign a contract with WeBank to apply for individual rental loans and authorize the bank to make payments to Phoenix Tree Holdings.

“Rental loans are targeted to individual borrowers, but the money is used by the company,” said a bank executive. It means the bank has no right to monitor how the funds are used as it doesn’t have a loan contract with Danke, the executive said.

“Such a loan model has loopholes in risk control, and almost no big bank is willing to do it,” he said.

Rental loans targeting individual renters thrived in China in recent years along with the rise of the long-term rental market. Small and private banks are the main players in the market. WeBank, China’s first internet-only lender, started the rental loan partnership with Danke in
mid-2018 and later became the company’s biggest financing partner, Caixin learned.

Several banking sources said they are surprised that WeBank became so deeply involved in the riskier rental loan business with Danke as the bank has sound profitability. In 2019, WeBank reported 3.95 billion yuan of net profit and 14.9 billion yuan of revenue, topping all private banks.

Caixin learned that WeBank also worked with rental business leaders Zifroom and Beijing 5i5j in rental loan partnerships. The bank said it monitors the partners’ financial and business disclosures closely for risk control and requires the companies to put up 5% to 8% of the total loan value as a provision against loan losses.

In the agreement with Danke, WeBank also limited the use of the rental loans to paying landlords and related spending. Danke promised to return funds to the bank if contracts with tenants are terminated early. But analysts said it is difficult for the bank to monitor how Danke used the money.

As Danke’s financial crisis intensified, WeBank terminated the partnership in November. The bank still holds 1.6 billion yuan of unpaid loans to Danke renters.

Although no agreement has been reached on a solution for Danke’s loan disputes with clients, some legal experts said WeBank should also assume part of the responsibility because of the risk control flaws.

Cai Zhen, a real estate industry expert at the National Institution for Finance & Development, said the renters’ loan obligations should be transferred to Danke for WeBank to claim its debts.

TikTok Rival Continues to Play Second Fiddle

Kuaishou Technology is on track to beat ByteDance to a public listing, but that’s just about the only metric the company is leading on.

By Guan Cong and Anniek Bao

Veteran Chinese short video app Kuaishou is tracking to be first to a public bourse, beating its bigger rival Douyin — the domestic version of TikTok — after it filed for an IPO in Hong Kong last month.

But a Caixin analysis and interviews with insiders at Kuaishou Technology Co. Ltd. show that’s about the only metric the company is leading on.

According to a prospectus filed to Hong Kong regulators last month, the Beijing-based firm has become the world’s largest livestreaming platform, second largest e-commerce livestreaming site, and has the second-largest number of daily active users (DAU) of any short-video company, citing data from iResearch.

The company is no slouch — Kuaishou said its revenue ballooned to 39.1 billion yuan ($5.9 billion) last year from 8.3 billion in 2017, and turned a loss of 521 million in 2018 into a profit of 689 million yuan last year.

But the devil is in the detail. Kuaishou reported 320 million DAUs in the first half of the year, while ByteDance’s Douyin said it had almost double that — 600 million — in August. The firm is also under pressure in its promising e-commerce revenue stream as Douyin builds a more robust, walled-off ecosystem.

Caixin has learned Kuaishou hopes to raise $5 billion in its IPO, valuing the firm at between $40 billion and $50 billion. That would value it about the same as TikTok’s business in North America, Australia and New Zealand combined.

Leadership questions

Nine-year-old Kuaishou kicked into high gear in mid-2019, doubling its staff to over 10,000, and restructuring its core businesses. Company sources told Caixin the reshuffles had left some in the firm unclear about who was calling the shots — product head Cheng Yixiao, or CEO Su Hua.

Cheng, who leads research and development on Kuaishou’s core products, holds a 10.02% share of the company and serves as chief product manager. Su Hua has a 12.65% share and controls more voting rights.

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more than 8.3 billion — about 95% of which came from livestreaming.

**Warning signs missed**

When Kuaishou became the world’s biggest livestreaming platform at the end of 2017, it was not counting on the stellar rise of Douyin. Kuaishou had more than 40 million DAUs in the second quarter of 2017; Douyin had several million.

The way Kuaishou insiders tell it, the company failed to play defense, even though some had warned management not to overlook the smaller firm.

Douyin ramped up marketing efforts after taking in $2 billion in investment in 2017 which valued the firm at $30 billion. Daily active users spiked to 70 million by February 2018. Douyin was setting new fashion trends which translated into product sales. “When searching ‘Douyin’ on Taobao, you would see products from Douyin’s videos, but searching ‘Kuaishou’ would only get you livestreaming equipment,” lamented one Kuaishou insider.

By 2018, Douyin, which was founded just two years earlier, set its annual revenue goal at 20 billion yuan. Kuaishou was aiming for somewhere between 20 and 30 billion yuan that year.

“It wasn’t that (Kuaishou CEO) Su Hua didn’t see the threat from Douyin,” one ByteDance investor said. “But he did not expect it to happen so fast.”

Kuaishou was valued at nearly $20 billion in March 2018 when it received $1 billion from around 10 investment firms including tech giant Tencent. Half a year later, ByteDance closed a $3 billion funding round and saw its valuation more than double to $75 billion. Nearly half of that valuation was for Douyin, several investors said.

**All eyes on e-commerce**

Kuaishou made a turn into e-commerce in August 2018, and the next year its gross merchandise volume (GMV) — the total value of goods sold on the app — had exploded to 59.6 billion yuan, up from just 97 million yuan. Its revenue from online retail increased 10 times to 259 million yuan in 2019, on the back of a roughly 5% commission it was taking on products bought from partner vendors.

In the first half of 2020, Kuaishou’s GMV rose to 109 billion yuan as the pandemic kept people at home, while its DAU eclipsed 100 million. But the average commission fees it took from transactions dropped to less than 1% because Kuaishou was paying small vendors to sell and remain on its platform, the firm’s director of creative content, He Haoxun, told Caixin.

Kuaishou’s potential to capitalize on livestreaming e-commerce is stronger than Alibaba, if Kuaishou’s 7.2 billion yuan worth of revenue from advertising in the first half is factored in.

Kuaishou said it was the world’s second biggest e-commerce platform in the first half by GMV, after Taobao’s livestreaming offerings. Taobao Live has 400 million users and over 1 million retailers on its livestreams, according to company data from March.

Kuaishou wants to facilitate 250 billion yuan worth of transactions this year, which would see it overtake Taobao Live’s 200 billion yuan in GMV for 2019. But He has played down the idea Kuaishou would seek to challenge Alibaba by copying the business model of Taobao or Pinduoduo, saying instead that it will use livestreaming commerce to grow its user base.

To that end, it has partnered with e-commerce giant JD.com Inc. with the aim of enticing users to buy products from JD without leaving Kuaishou’s interface, instead of simply searching and purchasing them on Taobao.

Compare that to rival Douyin, which has been developing an independent e-commerce supply chain, after the August purchase by ByteDance founder Zhang Yiming of a Wuhan company with a coveted online payment license opened the door for his firm to free itself from intermediaries.

Douyin removed links to third-party e-commerce platforms Taobao, JD.com and Pinduoduo from its app in October.

**Kuaishou in the north**

By 2018, Douyin and Kuaishou had become China’s two largest short-video platforms. But they were markedly different in terms of culture, target audiences and brand image — encapsulated in the phrase “Douyin in the south, Kuaishou in the north.”

Kuaishou had failed to penetrate in China’s hipper southern megacities like Guangzhou and Shenzhen. In 2019, the company ramped up advertising there and launched a blitz called “K3,” with CEO Su Hua targeting 300 million DAUs and 15 billion yuan of revenue in advertising that year. The teams responsible for Kuaishou’s ads business expanded from dozens of people to over 60 and the advertising department was transformed.

The firm achieved a coup when it became the exclusive short video partner for the Spring Festival Gala of 2019, China’s most watched annual broadcast event. That was not cheap — the firm paid 3 billion yuan for the rights — but it did help the company hit its DAU target.

The DAU blitz did not translate into long-term revenue, however. The company made 7.4 billion yuan from ads last year, falling short of Su Hua’s target by half.

**Uncertainty overseas**

The story of ByteDance’s overseas forays is well known. What looked to be China’s first truly global internet success story was disrupted by allegations of data theft, wound up in the crosshairs of the U.S. president, and was targeted globally in a Washington-led campaign.

Unlike ByteDance, which highlighted its international achievements through multiple funding rounds, the touchy issue of Kuaishou’s overseas ambitions was conspicuously absent from its prospectus.

Kuaishou’s Zynn, with which it hoped to tap the U.S. market, has come under attack from American Senator Josh Hawley, who wants the U.S. Federal Trade Commission to investigate the short video app on national security grounds. It has been removed from the Apple and Google app stores for engaging in unfair competition and paying users to watch ads and use the app, which had helped boost it into the top three for downloads in June.

Kuaishou has other international offerings. Aside from Zynn, it has Kwai, which has gained some popularity among Russian teenagers and is now targeting Latin America, as well as SnackVideo in India. Other international products...
include social media site Lolita, video editing toolkit MVMaster, and short video communities UVvideo and VStatus.

Kuaishou has fallen victim to the same geopolitical uncertainties as other Chinese tech firms. Following a violent border clash between India and China in June, Indian authorities introduced tit-for-tat retaliatory measures including a ban on the use of Kuaishou’s Kwai, UVVideo and SnackVideo, along with ByteDance’s TikTok, Alibaba’s Taobao and Tencent’s WeChat.

Company sources told Caixin that international expansion was part of Su Hua’s plan, though no systematic vision has been made public. “There’s no clear strategy,” an former alumnus of both ByteDance and Kuaishou told Caixin.

The company has opened offices in 26 cities in countries including the U.S., India, Singapore and Indonesia.

In the wake of the planned Trump administration ban on TikTok which is now in limbo, Cheng was asked at a September summit if Kuaishou planned to follow the company into the North American market. “We often cannot reverse broader trends, but we are hoping to bring better services to as many users as we can, even if there’s only a slight chance.”

**BUSINESS & TECH**

Why Ant’s IPO May Stay on Ice

Tough new regulations for microlending may force significant changes for fintech giant’s platforms and a big haircut off its $302.5 billion valuation

By Liu Caiping, Zhang Yuzhe, Yue Yue, Wei Yiyang and Han Wei

Now that Ant Group Co. Ltd.’s would-be record initial public offering is on ice, what’s next for the high-flying fintech behemoth and investors who hoped to make a quick killing?

Both may be in for a long wait as Ant Group adapts its business to tough new regulations on microlending, one of the company’s biggest business drivers, according to analysts, investment bankers and market experts. And whenever it comes back to the market, Ant is likely to face a significant haircut off its valuation of 2 trillion yuan ($302.5 billion).

The shockwaves of the suspension will spread far beyond Ant Group and affect other fintech companies weighing initial public offerings (IPOs), an investment banker said. They include JD Digits, the fintech arm of JD.com, which in September issued a prospectus for a 20 billion yuan offering in Shanghai, eyeing a valuation of 200 billion yuan.

How regulators put Ant Group’s booming online credit business under oversight will set an example for regulation of the rest of the industry, a person close to China’s central bank said. The issuance of new draft rules Nov. 2 for online microlending activities forced the surprise suspension of Ant Group’s debut, planned for three days later.

Ant Group apologized to investors who put up trillions of yuan to subscribe for its shares and promised to properly handle follow-up issues. Procedures for refunding investors have started in Hong Kong and Shanghai.

The regulations proposed by the People’s Bank of China (PBOC) and the China Banking and Insurance Regulatory Commission (CBIRC) stipulate stricter standards for a range of operational and financial metrics including leverage levels, joint lending and cross-province business.

Regulators said the toughened rules aim to “regulate the online microfinance operations of microlenders, prevent risks from online micro loans, protect the legal rights and interests of microlenders and clients, and promote the healthy development of the online microfinance business.”

The move caught Ant by surprise. Hours earlier, Ant Group staffers finished all setups and rehearsals for the stock debut on the Shanghai Stock Exchange.

“It seems Ant Group wasn’t aware of (the changes) beforehand and was not prepared,” an investment banker said.

Ant Group had marched at lightning speed toward its mega IPO since the plan was announced in July, sparking an investor frenzy. But the triumphant sentiment quickly turned on Nov. 2 when financial regulators in China summoned the company’s top executives including billionaire founder and controlling shareholder Jack Ma for a regulatory interview.

Regulators called off Ant Group’s share sale in Shanghai late Nov. 3. Half an hour later, Ant Group put up a statement on the Hong Kong bourse saying the concurrent offering in the city was also suspended.

The shockwaves of the suspension will spread far beyond Ant Group and affect other fintech companies weighing initial public offerings (IPOs), an investment banker said. They include JD Digits, the fintech arm of JD.com, which in September issued a prospectus for a 20 billion yuan offering in Shanghai, eyeing a valuation of 200 billion yuan.

How regulators put Ant Group’s booming online credit business under oversight will set an example for regulation of the rest of the industry, a person close to China’s central bank said. The issuance of new draft rules Nov. 2 for online microlending activities forced the surprise suspension of Ant Group’s debut, planned for three days later.

Ant Group apologized to investors who put up trillions of yuan to subscribe for its shares and promised to properly handle follow-up issues. Procedures for refunding investors have started in Hong Kong and Shanghai.

The regulations proposed by the People’s Bank of China (PBOC) and the China Banking and Insurance Regulatory Commission (CBIRC) stipulate stricter standards for a range of operational and financial metrics including leverage levels, joint lending and cross-province business.

Regulators said the toughened rules aim to “regulate the online microfinance operations of microlenders, prevent risks from online micro loans, protect the legal rights and interests of microlenders and clients, and promote the healthy development of the online microfinance business.”

The move caught Ant by surprise. Hours earlier, Ant Group staffers finished all setups and rehearsals for the stock debut on the Shanghai Stock Exchange.

“It seems Ant Group wasn’t aware of (the changes) beforehand and was not prepared,” an investment banker said.

Ant Group had marched at lightning speed toward its mega IPO since the plan was announced in July, sparking an investor frenzy. But the triumphant sentiment quickly turned on Nov. 2 when financial regulators in China summoned the company’s top executives including billionaire founder and controlling shareholder Jack Ma for a regulatory interview.

Regulators called off Ant Group’s share sale in Shanghai late Nov. 3. Half an hour later, Ant Group put up a statement on the Hong Kong bourse saying the concurrent offering in the city was also suspended.

The dual listing was set to become the world’s biggest ever, raising $34.5 billion.

Pull the trigger

Controversy surrounding Ant Group flared up in late October after Ma publicly criticized local and global financial
regulators for hampering innovation in the name of preventing risks. At a high-level financial summit in Shanghai, Ma compared the Basel Accords, which set out global capital requirements for banks, to a club for the elderly and blasted out global capital requirements for banks, compared the Basel Accords, which set a level financial summit in Shanghai, Ma deliberated on the supervision of Ant Group as the company has grown into a conglomerate that combines a wide range of financial and nonfinancial businesses.

Several senior government officials attended the same summit, including Chinese Vice President Wang Qishan, who called for balance between financial innovation and supervision. Application of new financial technologies and the emergence of new businesses have increased efficiency and convenience but also have amplified financial risks, Wang said at the conference.

Ma’s comments apparently caught the attention of regulators. One week after the summit, the State Council, China’s cabinet, at a meeting emphasized the importance of regulatory oversight and risk control treating all business players fairly.

An article published by a central bank-backed newspaper said regulators should deliberate on the supervision of Ant Group as the company has grown into a conglomerate that combines a wide range of financial and nonfinancial businesses.

Backed by the popular payment service Alipay, Ant Group has tapped into a sprawling array of financial services including online banking, insurance, wealth management and credit, but it has not been subject to the same capital adequacy and leverage requirements as traditional financial institutions.

The article suggested drawing a clear boundary between Ant Group’s financial and nonfinancial businesses while integrating similar services so that every aspect of its businesses can be covered by proper supervision and follow related risk-control requirements.

The booming online micro-lending sector backed by fintech companies remains a key concern of regulators due to risks of excessive leverage.

Ant Group is the biggest online consumer credit provider in China through its Huabei (花呗) platform, which offers credit lines for small unsecured loans to customers for daily expenditures, and Jiebei (借呗), which offers short-term unsecured loans for larger transactions, according to Ant’s IPO prospectus. The online micro-lending business segment has become the company’s biggest income driver, contributing nearly 40% of revenue and 48% of net profits.

The proposed regulations on micro-lending, if approved in their current form, will create headaches for Ant Group as they may force the company to change the way it raises money to fund Huabei and Jiebei and crimp their expansion in the short term, analysts said.

Changes in fintech industry regulations will have a “huge impact” on Ant Group’s operational structure and profit model, said the China Securities Regulatory Commission in a statement backing the Shanghai bourse’s decision to suspend the offering.

Regulators can use Ant Group as the sandbox for the biggest and most complicated supervisory experiment for fintech companies, a person close to regulators said.

“Financial regulatory bodies have been discussing the supervision framework for financial technology companies for a long time, and related studies are already in front of authorities,” a regulatory official said. “It is just a question of time to make the determination.”

### Changing environment

The draft online micro-lending rules would mean a major revamp to Huabei and Jiebei, which managed a combined 2.15 trillion yuan of outstanding loans as of the end of June, according to Ant Group’s prospectus. The two platforms are operated by companies registered in the municipality of Chongqing in Southwest China — Chongqing Ant Shangcheng Micro Loan Co. Ltd. and Chongqing Ant Small and Micro Loan Co. Ltd.

The rules stipulate that online micro-lending businesses can operate only within the province or region where they are registered and limit the leverage ratio of micro-lenders to 16 times net assets. Analysts have widely estimated that Ant Group’s online lending business has a rough leverage ratio exceeding 60 times net assets.

The more pressing change for Ant Group in the new rules is tighter oversight of joint loans that originate through cooperation with other financial institutions. Online micro-lenders should fund at least 30% of any joint loan with financial institutions, according to the draft, which doesn’t specify what the
Hong Kong investors would get refunds on the reasonable demands of investors and work out a feasible plan.


effective plan

% to 5%.

According to Ant Group’s prospectus, about 1.75 trillion yuan of loans issued through its online credit platforms were through cooperation with banks. Ant Group helped market about two-thirds of the loans while putting its own money into the rest.

With its control over massive online traffic, Ant Group has partnered with more than 400 financial institutions in offering credit services to online shoppers. Ant Group charges the banks service fees or shares part of their interest income from the loans. Sources told Caixin that Ant Group often contributes 1% to 10% in the joint loans issued with banks, far less than the 30% requirement.

To meet the new hurdle would mean that Ant Group would have to either dramatically reduce its loan size or increase capital by billions of yuan, analysts said.

The new rules could slash Ant Group’s profits on credit-related businesses from the current 10 billion yuan to 4 billion yuan, said Ji Shaofeng, a microlending business analyst. That would reduce Ant Group’s valuation to less than 1.5 trillion yuan from nearly 2 trillion yuan currently, Ji said.

What’s next?

Millions of investors were rattled by the suspension of the offering. Ant Group and its underwriters have started to refund investors who subscribed to buy the stock, but some investors will still bear losses, especially for those who borrowed heavily for the investment.

A record 1.55 million mom-and-pop investors subscribed to the Hong Kong portion of the dual offering, putting up HK$1.3 trillion (US$167.69 billion) for the shares. A local newspaper reported that financial institutions in Hong Kong loaned as much as HK$19.2 billion to Ant Group IPO investors. Banks and brokers offered low interest rates of 0.5% to 4% annually, leading to interest costs for investors totaling HK$36 million to HK$284 million for the five days before the scheduled debut, according to Caixin calculations. Ant Group promised that Hong Kong investors would get refunds on Nov. 4 and 6.

Hong Kong’s Financial Services and Treasury Bureau said the incident won’t affect the stability of the city’s financial system.

On the mainland, underwriters of the Shanghai offering also pledged to return funds and brokerage commission fees plus interest to investors. The money should be back in investors’ accounts by Nov. 9, and the shares they subscribed to were canceled Nov. 6, Ant Group said.

There are also more than 10 million retail investors who put up 60 billion yuan with five publicly offered funds that were set to acquire 11.97 million yuan of Ant’s shares along with other assets. With Ant Group’s offering suspended, some investors demanded refunds or changes in the funds’ investment terms.

Regulators urged fund managers to fully consider the reasonable demands of investors, work out a feasible plan in accordance with the law, and effectively protect the legitimate rights and interests of investors.

The CSRC said in a separate statement that the decision to suspend a “hasty” IPO of Ant Group amid a changing regulatory environment will protect investors and ensure accurate, transparent information disclosure.

A person with knowledge of the situation said regulators’ decision to halt the offering followed consultations with some domestic and overseas investors to make sure the losses caused by the suspension were acceptable. If the regulatory changes had come after Ant Group’s flotation, it might have led to significant fluctuation of the stock and cost investors even more, the person said.

According to the rules of Shanghai’s STAR Market, Ant Group has one year to complete its offering. But analysts said they don’t expect a resumption of Ant Group’s IPO to come soon. It will take time for the company to comply with the new rules and seek a new valuation, they said.

Most analysts interviewed by Caixin said they think Ant Group’s valuation will be significantly affected by the regulation changes. Some said the current valuation is too high.

“The precondition of (IPO resumption) is to fully meet regulatory requirements,” one industry expert said. “It won’t only affect Ant Group’s valuation but also force a great reduction of the size of businesses such as Huabei and Jiebei.”

Alibaba Soothes Market Watchers

Chairman and CEO thanks government for encouragement, pledges support for regulation

By Yuan Ruiyang and Timmy Shen

After the Chinese government’s smackdown of fintech giant Ant Group Co. Ltd. and its founder Jack Ma for challenging the country’s financial watchdogs, the billionaire’s e-commerce vehicle is taking a more conciliatory approach to market regulators.

Speaking at a government-sponsored internet summit on Monday Daniel Zhang, Alibaba Group Holding Ltd.’s chairman and CEO, said the company will “actively learn from and respond to national policies and regulations.”

“In the process of great development, new problems and challenges will arise, and policies and regulations that keep pace with the times are needed to manage them,” Zhang said. Recently published draft regulations governing the behavior of internet platforms are “timely and necessary,” he said.

Zhang’s comments were made at the high-profile World Internet Conference, also known as the Wuzhen Summit, an annual event organized by the Cyberspace Administration of China and other government agencies. His praise of market watchdogs contrasts sharply with the antagonistic speech made by Jack Ma at an equally high-profile financial summit in October in front of top regulatory officials.

Although Ma has no official position at either Ant Group or Alibaba, he is the “ultimate controller” of the fintech platform, according to the company’s...
IPO prospectus, and still had a 4.8% stake in the e-commerce giant as of July 2. As arguably the most influential figure in the development of China’s internet sector, his comments make headlines.

Ma’s harsh criticism of China’s financial regulatory system was widely interpreted as contributing to the decision by watchdogs to call the billionaire and other top Ant Group executives in for a dressing down by on Nov. 2, days before the fintech giant’s shares were due to start trading in Shanghai and Hong Kong in what would have been the world’s largest ever IPO. The $34.5 billion offering was pulled in the wake of the meeting which coincided with the publication of draft regulations to rein in the growing power of online finance platforms.

Although Zhang didn’t specify which regulations he was referring to, it’s likely his target was the State Administration of Market Regulation (SAMR), the government agency responsible for oversight of market competition, monopolies, intellectual property, and drug safety. SAMR released draft rules on Nov. 10, a day before the country’s Singles Day online shopping extravaganza, aimed at preventing monopolistic behavior by internet platforms such as Alibaba, e-commerce platform JD.com Inc., and Tencent Holdings Ltd., which operates the WeChat social media platform.

Their publication followed a Nov. 6 meeting of the market regulator, internet regulator and the State Taxation Administration where officials made it clear that internet platforms should not abuse their dominant positions to force merchants to choose between platforms.

In addition to stamping out monopolistic practices by internet platforms, the proposed rules seek to lower compliance costs for law enforcement and business operators, enhance and improve antitrust regulation of the platform economy, protect market fairness, ensure the interests of consumers and society, and encourage the healthy and continuous development of the platform economy.

In his speech, Zhang was fulsome in his praise of the role of market watchdogs. He said the development of the internet sector and government regulation is “a relationship where the two promote and rely on each other,” so platform enterprises can not only better develop themselves but serve the sustainable and healthy development of the entire society, he said.

China’s digital economy has developed to take a leading position in the world and has given rise to a number of excellent internet companies and platforms, Zhang said. “This is due to the great era of China’s reform and opening up, government policies to encourage development and innovation, and China’s position as the world’s largest market.”

Calls have been growing over the past few years for tighter oversight of the internet economy to prevent dominant players such as Alibaba, Tencent, JD.com and Meituan Dianping from abusing their positions. Several scholars have told Caixin that the attitude toward regulation has been too loose.

Although China introduced anti-monopoly legislation 12 years ago, there have to date been no major punishments meted out under the law, even as the digital economy has increasingly concentrated around two companies — Alibaba and Tencent — across everything from digital payments and finance to e-commerce and gaming.

In January, the authorities released a draft revision of the Anti-Monopoly Law, the first overhaul since it was promulgated in 2008, aiming to give the law more teeth and rein in the dominance of the country’s internet goliaths. The draft broadens the criteria used to assess a company’s control of a market and, for the first time, brings internet companies under the scope of the law.

On Thursday, China announced that it will set up a new joint task force backed by 17 central government ministries and departments to combat unfair competition as regulators tighten scrutiny of market dominance built up by tech giants. The new committee will coordinate supervision of unfair competition and lead policy-setting efforts to protect market order.
The Big Crackdown

How Chinese police clamped down $153 billion of illegal online gambling enabled by China’s e-commerce giants

By Zhang Yuzhe and Denise Jia
A migrant worker from the northern Chinese city Baoding “loaned” three credit cards under his name to friends to offset 2,500 yuan ($380) of debt he owed. He never imagined he would later be arrested for illegal sale of credit cards that were used by criminal groups to launder money for online gambling.

This arrest was part of Chinese authorities’ nationwide “Card Breaking Campaign,” an operation to crack down on illicit bank card transactions and bank card sales to combat telecommunications fraud and cross-border online gambling. The campaign aims to cut off links between mobile phone SIM cards and bank cards, and users who are not the registered card holders. Also included are online payment accounts such as Tencent’s WeChat Pay and Alibaba’s Alipay.

This new type of crime has created an illegitimate industry employing 5 million to 6 million people involving information technology (IT), payment settlements and operations, according to an IT department official at the Ministry of Public Security. The complex payments and money laundering system ropes in small individual players in some of China’s remotest places who loan or lease financial credentials to offshore criminal groups, which then help illegal gamblers hide money from authorities, often using Tether Ltd.’s USDT cryptocurrency.

In the first nine months of 2020, police cracked down on 1,700 online gambling platforms and 1,400 underground banks involving more than 1 trillion yuan of illegal transactions, data from the Ministry of Public Security showed. That compared with 7,200 online gambling cases in 2019 totaling 18 billion yuan.

In the cross-border online gambling chain, mobile payments play an increasingly important role. As the front-runner in mobile payments, China has been aggressively promoting payments via mobile phone scans of QR codes, a type of barcode. In China, even a street food vendor owns a unique QR code for receiving mobile payments. The convenience associated with mobile payments has also attracted criminal gambling groups.

‘Running points platforms’
As almost all forms of gambling are illegal under Chinese mainland law, if a Chinese citizen wants to bet using offshore online gambling sites, the first obstacle is depositing money at gambling platforms. These operations often use leading e-commerce platforms and delivery companies to facilitate massive fund transactions disguised as legitimate online shopping deals.

For example, a Caixin reporter tried to deposit 100 yuan via online banking to a gambling site called “DreamGaming.” The transaction showed the money went to an Alipay account linked to a grocery store. That gambling site can no longer be accessed as a notice says “it contains illegal content.”

Online gambling sites usually use so-called “running points platforms” to launder gamblers’ funds to look like legitimate payments. To deposit funds, a gambler follows a payment link on a site that connects to a running points platform. This platform is like a car hailing system. A registered member of the platform will “grab orders” and upload the funds using someone else’s purchased or borrowed bank account. Then the money’s transferred to the offshore gambling site. The platforms make a commission of 2.5% to 4% on the transactions, and the members get a cut of 1% to 2%, according to police.

Chinese social media such as WeChat and Weibo often carry advertisements recruiting part-time workers. Many of these advertisements are posted by running points platforms, which would pay 500–1,000 yuan to each recruited member for their ID numbers, bank cards, mobile phone numbers and bank USB-shield, which is a security tool that looks similar to a flash disk and acts as a shield to protect user’s money in internet banking. If more information can be provided, such as a business license, business seal, business bank account and USB-shield, the price can go up to 1,500–2,000 yuan for the whole set.

To some young jobless people from smaller cities and rural areas, the chance to generate 1,000 yuan from leasing their bank accounts or QR codes is a big temptation, said an insider at a payment process company. And the more transactions go through their accounts, the more they can make in commissions. Of course, they run the risk of arrest for participating in illegal activities.

In June, police in the southwestern Guangxi Zhuang autonomous region destroyed a cross-border online gambling operation involving 30 billion yuan of fund transfers through running points platforms.

Another channel for depositing money into online gambling sites is through mobile phone credit refills. These transactions are disguised as normal credit additions for mobile phone accounts but actually funnel money into gambling sites.

Cryptocurrency money laundering
After the running points platforms collect money from gamblers, how does the

Bank cards confiscated by Guangdong police in authorities’ “Card Breaking Campaign.” Photo: VCG
Cross-Border Online Gambling Funding Chain

Buying banking information
Recruiting part-time members

Banking Info Collecting Groups

Accept funds from gamblers and receive commission
Distribute refill tasks

Running points platforms/Mobile phone refill platforms (with offshore servers)

Distribute refill tasks
Receive commission

Overseas online gambling sites (with offshore servers)

Profits laundering

Domestic
Offshore

Chief plotter
Provide services

Planning team (overseas)
Illegal settlement platforms
Software companies

Transfer funds in name of payroll service
Transfer funds through bank cards

Individual bank accounts

Trade USDT at cryptocurrency exchanges
Money laundering through underground banks

Sources: Caixin reporters’ interviews
money get to the gambling operators? The traditional path is through illegal underground banks, which facilitate illegal foreign exchange and cross-border trading. These illegal underground banks have long existed in China to help citizens transfer money out of the country, often to buy property abroad.

A new practice involves Tether’s USDT, a cryptocurrency linked to the value of the U.S. dollar. The original goal of the cryptocurrency was to solve the problem of excessive value volatility. In 2019, USDT surpassed Bitcoin as the most-traded cryptocurrency on the market by volume.

USDT is widely used in money laundering, gambling, and other illegal activities, an executive at a blockchain platform told Caixin. In October, a local branch of the People’s Bank of China in the southern Chinese city Huizhou conducted mass arrests related to cross-border online gambling, the first crackdown on activities involving USDT. In a blog post, the central bank said 77 suspects were arrested for using USDT in cross-border transactions to launder gambling proceeds worth nearly 120 million yuan.

Most USDT transactions in the Huizhou case were made on Huobi, a Seychelles-based cryptocurrency exchange founded by Tsinghua University graduate and former Oracle engineer Leon Li. Online gambling sites use gamblers’ funds to buy USDT on Huobi and then sell the cryptocurrency, thus “washing” the funds into legitimate cash flow, Huizhou police told Caixin.

China’s public security authorities ordered Huobi and other USDT exchange platforms to strengthen their anti-money laundering efforts by adding video identification verification during transactions to make sure bank cards linked to a trader’s account actually belong to the trader. But the exchanges haven’t done so.

An executive at Huobi told Caixin the company completed its biggest upgrade in anti-money laundering risk control in August, without specifying the measures taken.

Huobi’s Li and Bitcoin exchange OKEx founder Xu Mingxing were reportedly cooperating with police on investigations of money laundering for online gambling.

The running points platforms and cryptocurrency exchanges place their servers offshore, increasing the investigative challenge facing police, Huizhou police said.

**Difficult to identify**

For online payment platforms such as WeChat Pay and Alipay, the great challenge is to identify which users’ accounts are actually running points platforms. Looking at data of accounts that might be used by running points platforms, the amount of transactions is usually small, and many of them seem to be normal payments for consumption, said Guo Qianting, general manager of Ant Group’s anti-money laundering center. Finding running points platforms among regular users is like looking for a needle in a haystack, she said.

Another money laundering channel is gig job platforms, which provide contractors and payroll services to employers in the food delivery, ride-hailing and e-commerce sectors. More than 10,000 such platforms have emerged in China since 2018. Some of them are service providers for legitimate companies including Meituan Dianping and Didi Chuxing. But many others are used to launder money for online gambling.

In May, a local branch of Agricultural Bank of China in Xiangtan, Hunan province, detected suspicious transactions at a gig job human resources provider. The company had more than 200 million yuan of cash transactions in just a dozen days, and most of the transactions took place outside normal business hours. Police found that the company laundered money for telecommunications fraud groups.

In November, another gig job platform backed by Ant Group, China’s dominant online payment service provider, was investigated for suspected money laundering activities. Beijing Bujiao Technology Co. Ltd. was suspected of having falsely issued more than 1.3 billion yuan of value-added tax invoices. Some of the company’s money laundering activities involved cross-border gambling, Caixin learned.

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**China’s Illegal Online Gambling Enablers**

Largely offshore gambling operators set up complex business chains linking Baidu, WeChat, Alipay, Pinduoduo and ZTO Express

By Tang Hanyu, Di Ning and Denise Jia

A dark corner of the cyber world benefited from increasingly convenient internet-based payment and logistics services as e-commerce soared amid the pandemic — illegal online gambling.

And the shadowy, often offshore operators of illicit gambling sites found unwitting or unwitting enablers in some of China’s leading tech giants, according to police who are conducting a massive crackdown on an unprecedented surge in online gambling.

Investigators found that illegal gambling sites have relied on major search engines and social media platforms that are household names to lure gamblers while using leading e-commerce platforms and delivery companies to facilitate massive fund transactions disguised as online shopping deals.

They include China’s biggest online search engine Baidu Inc., Tencent Holdings’ messaging apps QQ and WeChat and Ant Group’s payment service Alipay, authorities say.
E-commerce site Pinduoduo appears to have been especially vulnerable. Investigators also implicated major courier companies including New York-listed ZTO Express, Shanghai-listed YTO Express and STO Express, as well as a number of logistics companies.

“Many large internet companies are involved in the investigations,” one police officer involved in the probes said.

The appearance of such icons of China’s booming e-commerce economy in gambling operators’ toolkits raises questions about whether the internet giants conducted adequate internal oversight and risk control efforts to vet illegal dealings, authorities say.

There’s little question that many of these companies profited from involvement in the gambling operators’ complex business chains, investigators say.

For their part, the legitimate online businesses say there are limits on their ability to monitor and prevent illegal activities. Most of the implicated companies are said to be cooperating with authorities. After a top Baidu executive was detained in the probe, Baidu pledged zero tolerance for violations and promised to assist police in the investigation.

“We’ve done everything we can do,” one Pinduoduo source said.

Based on law enforcement data, the surge in illegal online gambling amid the pandemic has been astonishing. By the end of September, Chinese authorities launched investigations of more than 8,800 cross-border gambling cases and arrested more than 60,000 suspects allegedly involved in the illegal businesses.

Police cracked down on 1,700 online gambling platforms and 1,400 underground banks, involving more than 1 trillion yuan ($151 billion) of illegal transactions, data from the Ministry of Public Security showed. That compared with 7,200 online gambling cases in 2019 totaling 18 billion yuan.

In Shenzhen, Guangdong province, police found that operators of an overseas-based gambling site marketed its games through QQ and WeChat and then directed gamblers to make nearly 2.6 billion yuan of payments for bets through Alipay and WeChat Pay.

In Wuxi, Jiangsu province, police in August arrested two people for selling 60,000 logistics records for nonexistent deliveries. The logistics records were used to fabricate online shopping deals for gambling sites to launder more than 7 billion yuan paid by gamblers, local police said. Most of the money was remitted through Alipay for bogus deals with tens of thousands of fake merchants on Pinduoduo, according to a person with knowledge of the matter.

Such cases show how gambling site operators set up complete business chains linking search engines, social media platforms, e-commerce sites, payment services and delivery systems to facilitate recruitment, transactions and money laundering. The gambling sites often use overseas servers with senior executives staying abroad to command a complex web of activities, according to police.

Although internet companies have argued that it is difficult to detect such illegal transactions and pledged to enhance risk control, analysts said none of the parties involved is really innocent because everyone benefits from the illegal dealings. For search engines, ad promotions generate revenues, while fake retail deals boost e-commerce platforms’ books and bogus deliveries offer logistics firms quick money, analysts said.

Serving the bad
Shi Youcai, the head of Baidu’s Mobile Ecology Group who oversees the company’s sales system, was detained Sept. 15 by police on allegations of helping online gambling promotions, putting the search engine giant’s controversial advertising operations under a spotlight. His detention followed investigations of seven other Baidu staffers starting weeks ago, including Vice President Li Zhongjun, Caixin learned.

Shi was later released on bail.

Shi, who worked at Baidu between 2001 and 2011, returned to the company in 2019 as a special adviser to a newly restructured mobile ecology division, becoming the de facto head of Baidu’s sales system.

Shi opened the door for illegal advertising on Baidu’s platform and benefited personally from the business, one person close to Shi’s management told Caixin. A Baidu business partner said Shi tightened control over Baidu’s advertising partners and offered favors to agencies with whom he had ties. Business with regulatory risks including promotion of card games could be conducted only with certain agents, the executive said.

Shi denied the allegations. Industry sources said it is almost impossible that senior company management didn’t notice the practices.

“Those (illegal) ads have always been there but were not investigated before,” said one online advertising customer.

“And Baidu is not the only one.”

A Caixin search of online advertising monitoring site Reyun showed that a 2019 ad for a gambling-like card game was promoted by a number of major platforms backed by tech giants including ByteDance and Tencent.

In late 2020, Tencent, WeChat and ByteDance have all published lists of ads that are prohibited on their platforms, including gambling, lotteries and healthcare services, among others.

While online advertising provides gambling sites access to customers, the more important part for their business is to set up a channel to funnel cash from users without being caught by regulators. E-commerce sites like Pinduoduo and logistics companies became part of their system.

Several online gambling participants interviewed by Caixin said they could top up their game accounts on gambling sites by simply scanning a quick response code appearing on the website and completing the payments through WeChat Pay or Alipay. After the payments, they got
potential violations. But a police officer disagreed. Screen shots of shops serving online gambling showed that their products were often labeled with extraordinarily high prices. For instance, a pair of slippers priced at 9.9 yuan at other shops had a price tag of 1,999 yuan on one of the gambling-linked shops.

“It should be very easily identified by e-commerce platforms to take risk control measures,” the police officer said.

According to Pinduoduo, the company assisted police in cracking down on more than 10 online gambling cases in the first half 2019 and reported 18,958 suspicious cases involving 1,719 merchants on its platform. Experts said the platform should be able to do more. A police officer focusing on online gambling told Caixin that compared with Pinduoduo, other major e-commerce platforms such as Alibaba’s Taobao and JD.com have seen far less gambling-related transactions.

That may partly reflect the stricter requirements on new shop registration applied by Taobao and JD.com, another police officer in Jiangsu said. There is no official disclosure on the size of gambling-related transactions on e-commerce sites. In 2019, Pinduoduo said it would remove revenue related to violations from its financial report.

In the third quarter of 2019 following the online gambling crackdown in August, Pinduoduo reported a surprise 2.3 billion yuan loss when analysts expected a net profit.

Logistics companies also played their part in the online gambling boom. Producing fake delivery records requires access to couriers’ systems and coordination among different departments of a company, police said. Police investigations of fake deliveries related to online gambling have targeted a number of senior executives of couriers and logistics companies who are suspected of involvement in fabricating delivery records, a Wuxi police officer said.

Whose responsibility?

With fabricated online orders and delivery records, the transfer of gambling funds is disguised as a normal online transaction. Pinduoduo said due to the lack of its own payment service, the company has difficulties fully controlling information related to each payment and detecting

Shop owners earn commissions from the gambling sites for managing the fake shops.

“I register a shop for them to use,” one shop owner said. “A piece of clothing was priced at thousands of yuan, and there were soon orders.” Such shops can post daily transactions between 5,000 yuan and 600,000 yuan, according to the source.

Following the fake online orders were a slew of delivery records for the nonexistent packages to complete the chain of business designed to cover money laundering. In August, police in Wuxi arrested two people suspected of selling 60,000 fake delivery records over two years that are believed to be linked to gambling-related money laundering.

The delivery records indicated orders from tens of thousands of merchants registered on Pinduoduo, mainly based in Zhejiang and Jiangsu. The transactions totaled 7 billion yuan, according to police.

receipts showing the money was received by “Pinduoduo platform merchant” or Shanghai Xunmeng Information Technology Co. Ltd. — the operator of Pinduoduo. With the transaction records, some of the gamers turned to Pinduoduo with complaints after they lost huge amounts of money.

But behind the payments was a complicated chain of business dealings that disguised the illegal transactions as normal e-commerce deals, Caixin learned. Each payment was linked to an online purchase order placed through a merchant on Pinduoduo with a traceable online shop and a clear order number.

Payers have no idea which merchant they paid or for what products. Pinduoduo’s customer service staffs said the company had no access to the details of orders, according to gambling participants.

People familiar with the matter said that all the merchants and purchase orders were fabricated to serve gambling transactions. Gambling site operators hire people to register a shop on Pinduoduo with their real identification and help them decorate the sites into seemingly normal online shops. But no real product has ever been delivered despite the digital transaction records, allowing the money to flow from gamers to gambling site operators, they said.
When the two coils that had spent close to two decades in her body were removed, Lu Ying (pseudonym) said she felt reborn.

Lu, from Pujiang county in East China’s Zhejiang province, had the first of the intrauterine devices (IUDs) fitted after she gave birth to her only child in 1993, to prevent her from getting pregnant again and violating the one-child policy.

Six years later, she was told by village family planning officials that the first coil “didn’t work” and that she’d have to get a second coil inserted. Soon after, her health began to deteriorate, with menstrual bleeding around three weeks per month and the desperate need to urinate every two hours, which has spoiled her sleep for over a decade.

Around 300 kilometers away from Lu’s home, Shanghai resident Teng Youxia has also spent decades dealing with the impact of her IUD. Teng’s abdomen is distended, giving her the appearance of being heavily pregnant, and she has suffered fatigue, chronic pain and excessive menstrual bleeding. She attributes these problems to...
a botched IUD removal 22 years ago.

Coils became widely used to enforce the one-child policy from the early 1990s, after design improvements were touted as causing fewer negative side effects. Women who refused to have an IUD inserted after giving birth faced punishments which varied across the country and at different times. One common punishment would be denying the woman’s child the all-important “hukou” household registration document, thereby locking them out of accessing public services such as education and healthcare.

One of the factors behind the health problems of this pair, and many other women like them, is the specific design and purpose of the IUDs commonly used in China. Unlike in some other countries, where these coils have a lifespan of a few years, in China they are usually intended to permanently curb the fertility of mothers. To this end, they are also difficult to insert and remove, requiring a surgical procedure rather than being able to be simply pulled out by their strings.

Problems including IUD expulsion, uterine perforation and inflammation are not uncommon, and can lead to serious mental and physical trauma.

Wu Shangchun, a birth control expert, told Caixin that many doctors and the women who have IUDs actually know little about them, which leads to problems in identifying complications and side effects.

Painful ordeal

In 1993, then 24-year-old Lu was fitted with a mandatory IUD. In 1999, when she went for her biannual health check with the family planning authority in her home village of Qiaoxi, she was told that her previous coil had “fallen out” and she would have to be fitted with a replacement.

Just a few months later, the bleeding started. At a check the following year, she asked if the coil could be changed — the first coil had not left her body before a second one was fitted.

While the county government offered her 20,000 yuan ($3,050) in compensation, Lu thought it an inadequate amount for 16 years of suffering and decided to take the government to court.

Teng had a different issue with her IUD, though it also had its roots in apparent medical error.

She too had a mandatory coil fitted by the family planning authorities of her hometown, Fanchang county in Anhui province, after giving birth in 1991. Side effects occurred immediately, including painful cramps and extended, heavy periods of menstrual bleeding. In 1998, she was told that the problems were due to the coil shifting several centimeters inside her body and that she’d have to have it surgically removed by the family planning authorities.

But after the surgery, her condition didn’t improve — it got worse.

Fifteen years later, a series of hospital tests in Shanghai showed that parts of the coil had remained in her pelvic region and that the removal had been botched. “Why didn’t the doctor in charge of the removal all those years ago inform me?” Teng asked.

In January 2014, surgeons attempted to remove the residue of the coil, but failed as the fragments had become too deeply embedded in her uterus. The next year, on the advice of her physician, Teng decided to have her uterus removed at Shanghai’s International Peace Maternity and Child Health Hospital. Teng says the surgeon removed her ovaries and cervix without her consent, leaving her incontinent, and that the problem of chronic bleeding remained. Later, she had to have yet another surgery on her bladder.

At this time, Teng asked Fanchang to officially recognize that she had complications arising from the IUD, but the government refused.

Failed lawsuits

Teng and Lu have both tried to use legal means to find justice, though they have taken different paths despite the similarity of their cases. However, neither has had much luck.

Lu appealed this sentence with the court at the prefectural city of Jinhua, which administers both Pujiang and Lanxi, but this was rejected. After several rounds of negotiation, she received 120,000 yuan from her village. While this was more than the government’s first offer of 20,000 yuan, it was far less than the 1.3 million yuan she had wanted.

Teng sued the Fanchang family planning authority, health commission and the Shanghai hospital which performed surgery on her for medical malpractice. However, the bureaucratic stumbling block here was whether or not the procedures carried out in the name of family planning could be classified as a form of medicine, and therefore whether or not they were covered by laws on medical malpractice.

In 2018, the court of Wuhu, the city which administers Fanchang, ruled that the malpractice law was not applicable in her case, and that moreover she couldn’t prove that the metal fragments in her uterus were from the IUD. Her appeal to the Anhui provincial court was rejected.

It is far from unusual for IUD-related cases to be rejected because the mingling of government and medical elements mean they don’t easily fit into any existing legal category. According to Caixin’s research, most cases of women suing the authorities over their IUDs have been rejected on such categorization grounds.

Even when cases are accepted, the burden of proof is particularly onerous. Such lawsuits usually require the participation of family planning experts who can clarify any relevant evidence — such as the metal fragments in Teng’s body. However, judicial authentication agencies — official bodies which assess evidence before it can be submitted in a lawsuit — don’t have staff with expertise in family planning, meaning it’s very difficult to submit evidence of harm in these cases, said Zhang Wensheng, a lawyer who previously worked at medical institutions.

In addition, these kinds of lawsuits take a long time but usually end in little reward. Lots of women cannot bear fighting for three to five years — in the end they give in and accept token compensation.
Official recognition

These challenges persist despite official recognition that IUDs can cause serious health problems. Documents on this issue were released in 1990 and 2011, which classify the common types of side effects and explain how they should be identified by officials at different levels. Women who are identified as having related complications should be provided with free treatment, the documents say.

Despite this, experts say that complications are still rarely identified through this process, and often free treatment isn’t made available even to those women who can prove they have suffered health problems due to their IUD.

Wu explained that many places still expect women to pay for any treatment related to complications from their IUD.

Lu says she isn’t satisfied with the paltry compensation she received, but has no idea what to do other than try to make the best of her life and put the pain she suffered for nearly two decades behind her.

Teng is less resigned, and is continuing her fight to hold someone accountable, though she feels bad for asking her family to help pay her medical and legal bills.

Expansion into wealthy Guangdong province gains momentum as Greater Bay Area integration picks up steam

Sitting at the heart of Hong Kong University of Science and Technology’s (HKUST) Guangzhou campus is an exact replica of the university’s iconic “Circle of Time” sculpture, commonly known as the “red bird” for obvious reasons.

The “sustainable, smart campus” established by HKUST, the Guangzhou government and Guangzhou University will begin enrollment in September 2022, after being approved by the Ministry of Education last year.

It’s not the only Hong Kong institution “heading north” to neighboring Guangdong province, of which Guangzhou is capital. Several of the special administrative region’s universities are doing the same, lured by tax and land incentives offered by the governments of cities including Foshan, Dongguan and Zhaoqing.

Guangdong local governments are hoping that Hong Kong universities will not only replicate their home institution’s artwork on their new campuses, but also their internationally recognized high standards, helping to boost the province’s lagging education sector and make the tech-producing region more innovative.

In part, the region sometimes touted as a challenger to Silicon Valley is trying to follow the example set by the original, where Stanford University, University of California Berkeley and San Jose State University churned out much of the talent that drove success.

Going north

Hong Kong universities’ move northward began at the turn of the century, when many set up graduate schools in Shenzhen. However the real forerunner of the current trend is Hong Kong Baptist University, which in 2005 teamed up with Beijing Normal University to open a campus in Zhuhai.

Then, in 2014, the Chinese University of Hong Kong (CUHK) opened a Shenzhen campus and soon became regarded as the tech hub’s top university. The success of CUHK (SZ) has often been attributed to its relative independence. According to public information, CUHK’s local partner, Shenzhen University, is not involved
Co. Ltd. On top of this, the region also has a rich ecosystem of startups, incubators and accelerators in tech, biotech, health-tech and innovation.

**Mutual limitations**

In the 2020 QS World University Rankings, Hong Kong had five universities in the top 100, while in Chinese mainland there were six, mostly located in Shanghai and Beijing. No Guangdong university cracked the top 300.

“Even though Guangdong has the largest GDP in the country, abundant land and financial resources, its overall educational level is still low, especially when it comes to the degree of internationalization,” Zheng Wen, then director of the higher education department of Guangdong province from 2012 to 2019, said in March last year.

Lu Xiaozhong of the Greater Bay Area Education Development Institute of South China Normal University, said that Guangdong has the most higher education institutions of any region in China, but that it possesses quantity not quality.

Even so, its gross enrollment ratio — the proportion of young people receiving higher education — remains below the national average of 51.6%, sitting at 46% in 2019, though this represents significant growth from 28% in 2010.

While Hong Kong has 35 higher education institutions, the city’s relatively small pool of students, shortages of cash and high land prices have constrained their growth.

All three are in abundant supply

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**Hong Kong Universities Set Up Guangdong Branches**

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<thead>
<tr>
<th>City</th>
<th>Branch Name</th>
<th>Founded/Started Year</th>
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<tbody>
<tr>
<td>Shenzhen</td>
<td>Hong Kong Baptist University Shenzhen Research Institute</td>
<td>2000</td>
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<td>Hong Kong Polytechnic University Shenzhen Research Institute</td>
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<td>Chinese University of Hong Kong Shenzhen Research Institute</td>
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<td>The University of Hong Kong Shenzhen Institute of Research and Innovation</td>
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<td>Chinese University of Hong Kong (Shenzhen)</td>
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<td>Hong Kong University of Science and Technology Fok Ying Tung Research Institute</td>
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<tr>
<td>Dongguan</td>
<td>City University of Hong Kong (Dongguan)</td>
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Source: public information compiled by Caixin
ENVIRONMENT & SOCIETY

Tensions in integration
In terms of academic freedom and autonomy, tension exists between universities on the mainland and those in Hong Kong. Academic studies run into restrictions on the mainland, especially in the fields of humanities and social sciences. Therefore the curriculums of these mainland campuses have been a long-standing question.

CUHK Vice President Chan Wai-ye said that the Shenzhen campus “uses the same curriculum as the Hong Kong campus, and if they plan to have new curriculums it has to be approved by Senate Committee on Teaching and Learning of CUHK.” The campus is also able to offer internet access subject to fewer of the mainland’s content restrictions than other mainland universities.

That’s a greater level of independence than was offered to pioneer Hong Kong Baptist University, whose mainland curriculum needs to be approved by both its parent institution and the education authorities of the mainland and Hong Kong. 

But experts told Caixin that China’s plastic restrictions need further refinement in order to be effective. “I think it’s still early days for this policy,” said Wen Zongguo, a professor at the School of Environment at Tsinghua University in Beijing. “There are still a lot of policy details to come out in the future, and many issues that need to be addressed more quickly.”

Missing understanding
Outdated standards and a flimsy policy framework are checking the progress of China’s biodegradable plastics industry, experts told Caixin.

The country’s standards for biodegradables have not been updated in 15 years and include materials that are not widely used or no longer meet internationally accepted definitions.

Additionally, China has no comprehensive system for recycling biodegradable plastics and lacks personnel who can distinguish them from traditional ones, said Wang Yonggang, the secretary general of the renewable plastics branch of the China Natural Resources Recycling Association.

As a result, both industry players and the general public lack a robust understanding of biodegradables, and “countless lies and specious arguments” plague the sector, said Wang Wang, the executive vice director of the plastic recycling committee at the China Synthetic Resin Association, an industry group.

Experts said China must pair the development of the biodegradable sector with better recycling mechanisms. “If we don’t build a proper system for recycling plastics, the problem will sooner or later come back to haunt us,” said Jiang Nanqing, the secretary general in charge of recycling at the All-China Environment Federation.

Capacity catch-up
China’s biodegradables industry also faces two other major issues: low capacity and high costs.

The two main biodegradable plastics used in China are PLA and PBAT. The former is a polymer made from plant sugar which degrades under industrial composting conditions, while the latter is a fossil-based material that degrades...
under both composting and natural conditions.

Both PLA and PBAT are more expensive to make than traditional plastics and carry additional recycling costs. These costs are usually passed on to downstream businesses and consumers, dampening demand for biodegradable products.

China's southern province of Hainan is a case in point. The island of 9 million people is something of a testing ground for progressive environmental policies and has more detailed regulations on biodegradable plastics than the rest of China. But its pivot away from traditional plastics is not going as smoothly as some would hope.

According to Chen Xi, an official at Hainan's environment bureau, the province consumes 40,000 tons of non-degradable disposable plastic bags and 25,000 tons of non-degradable plastic tableware per year.

Shifting that consumption toward biodegradables is no easy task. The island's largest supplier of biodegradable plastic bags is Zhongke Xinhui (Hainan) New Material Technology Co. Ltd., which currently has a production capacity of just 7,000 tons per year.

According to Gong Zhen, Zhongke's deputy general manager, the company makes the bags mainly from PBAT, which it buys from four major domestic suppliers. Although it is possible to make the bags from PLA, China lacks the technical know-how needed to use one of its key raw materials and cannot challenge the global industry leader, U.S.-based NatureWorks LLC.

“Even if you have money, you can’t buy PLA at the moment,” said Gong, adding that Zhongke uses other materials, like plant fiber, in products like its environmentally friendly tableware.

But no matter which material he uses, the end product typically costs more than its traditional plastic equivalent. Several industry insiders Caixin spoke to for this story said companies with high plastic use, like express delivery services, takeout services and users of agricultural sheeting, worried that the higher costs of biodegradables will make their business models unsustainable.

“The cost and price of biodegradable products are currently two to three times those of ordinary products,” said Ji Junhui, the director of the Hainan Province Biodegradable Technology Innovation Center. “Just from a price perspective, we can’t rely solely on the environmental consciousness of consumers.”

**Setting up systems**

Hainan’s disposal mechanisms for biodegradables also leave much to be desired.

The province’s patchy collection, composting and recycling systems mean that it still processes many biodegradable products like other forms of waste. “Once household garbage is classified, some of it is comprehensively utilized, and some is incinerated,” said Chen, of the provincial environment bureau. “But there is currently no separate disposal method for plastic products.”

Hainan also lacks a composting and recycling system for biodegradables, although one is in the planning stage, said Wang Xiuhao, an official focusing on biodegradable plastics at Hainan’s industry and information technology bureau. Currently, only one Chinese company is known to have attempted such a project on an industrial scale.

The island’s struggles cast doubt on China’s ability to extend a plastic bag ban nationwide on Beijing’s projected timeline, Ji said.

He estimated that the country will need to produce between 5 million and 6 million tons of biodegradable plastic per year to support such a ban, far more than China’s current production capacity of 400,000 tons, according to a Hainan policy document.

Ji said he expected the government to issue new standards in due course. “If these requirements don’t come out, (Hainan’s) plastics ban is effectively waste paper,” he said.

Others remain bullish. As long as China enacts policies to manage the aforementioned issues and cultivate the market, downstream demand for biodegradables could spur the development of upstream industries, said Wang Xiuhao.

Tsinghua professor Wen said current policies left ample leeway for firms to adapt to a biodegradable future, but conceded that current policies and regulations had caused a “relatively high degree of uncertainty” regarding the production and applications of biodegradables.

For now, Hainan should focus on collecting as much biodegradable plastic as possible and providing the conditions for decomposition, Chen said.

“The vast majority of the public, industry, specialists, government departments, cities, counties and third-party environmental charities supported the work plan,” he said. “There are obviously different voices in this debate, but we must still follow the choices of the majority.”
HIV Discrimination

Caixin traveled to the northeastern city of Shenyang to photograph the daily lives of some of the country’s 963,000 people infected with the virus that causes AIDS

By Liang Yingfei and Wang Xintong
When De Xiang, a pseudonym, first learned he was HIV-positive, his first reaction was one of despair. “All I thought about was when I would leave the world. Should I tell my family? I tried several times, but the words still wouldn’t come out,” he says.

De, a 59-year-old man who works as a caregiver in Shenyang, capital of Northeast China’s Liaoning province, was diagnosed with HIV in 2010. After that he decided he would never go back to his hometown, keeping his condition a secret and planning to live alone in the city until he could work no longer.

About 38 million people in the world are currently living with HIV, including 963,000 in China, according to a report by the World Health Organization. Due to its frequent transmission through sexual conduct, it has become strongly associated with promiscuity and homosexuality. Accordingly, lots of patients spend years not only fighting the disease, but also suffering from psychological and social problems as a result of being stigmatized and discriminated against.

In a village located 40 minutes west driving from downtown Shenyang, HIV carrier Guo Xing, 51, has taken up residence, together with some stray dogs that have now become his only companions. Every Saturday morning, people living with HIV gather at a community center where they can dance, sing and drink tea.

Guo, a 51-year-old man who was diagnosed with HIV in 2011, rests in his room in a village near Shenyang. He lost his job as soon as news of his condition spread and moved to the village to reduce his living costs.

Advances in medicine mean that HIV is no longer a death sentence, but instead can be managed similarly to less serious conditions like high blood pressure and...

7. Liu’s folded dance attire on a table. Liu was deeply influenced by a high-profile ballet called “White-Haired Girl” when he was a child. After he retired, he began performing with a dance troupe, which took up most of his time. Photo: Liang Yingfei/Caixin

diabetes. Patients can expect to live almost as long as people without HIV if they take regular medication. But other challenges like loneliness and isolation have taken the place of the more serious life-or-death threat, especially for those aged 50 or above.

Before his infection, De had already longed for someone who could spend a lifetime with him, even if that companion was wheelchair-bound or bedridden. But now his hopes are fading due to his infection.

“I don’t want to hide my disease, but I’m still afraid that the companion I’m seeking won’t accept it,” De said, “I met a person of similar age and with similar interests and asked what he thought of people with HIV. He told me I wouldn’t dare to touch such a person. I got his point and gradually distanced myself from him.”

As more patients learn to live longer with HIV, loneliness has become an urgent issue that needs to be addressed, experts say.

Such negative feelings can lead some to stop treatment or fall into deep depression, said Li Xin, a doctor who has studied the matter. Every year, Li said she will see two or three deaths of patient related to such reasons. “I didn’t think their lives should have ended this way, they deserved better choices,” she says.
Adhering to the “customer-oriented” service concept, developing in market-oriented revolution, and exceeding in differentiating strategies, over the past 32 years, Industrial Bank of China (CIB) has developed as an integrated financial group from a small local bank. With banking as its main business, CIB has multiple fields such as trust, financial leasing, fund, futures, asset management, consumer finance, research and consulting, and digital finance covered, ranking amongst the top 30 in World Banks and top 100 in World’s Largest Public Companies as well as ranking in Fortune Global 500.

With financial supporting, we will be able to create surroundings full of green, establish a human habitant environment and at the same time realize the sustainable development. Starting from leading the Green Finance of the Chinese market, being the first EPFI (Equator Principles Financial Institution) in China, and then being the first group of institutions in the world signing the Green Investment Principle for the Belt and Road and the Principles for Responsible Banking (drafted by UNEP Finance Initiative), CIB combined duties with profits, devoted itself to improving eco-environment and providing financial supports to sustainable development for over a decade. Till the end of 2019, CIB has provided a green financing balance of RMB101.09 billion in total, meanwhile has become the largest green financial bond issuer who has the largest amount of balance in the world.

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Biden Likely to Rework Trade Deal

Any new agreement is unlikely to be reached until late 2021, while a reduction or removal of existing U.S. tariffs is not expected

How might U.S. economic and foreign policies be different under a Biden administration and what might be the implications for China? What are the risks in the coming months?

As the UBS U.S. economics team wrote earlier, the size of Washington’s fiscal stimulus will likely differ a great deal under different combinations of the White House and Congress. On the other hand, the U.S. president has control over foreign and trade policies, which would impact U.S.-China relations and trade war. Compared to a Trump presidency with a split Congress, we think a Biden presidency with a split Congress may bring the following changes that are most relevant for next year’s economic outlook in China:

Lower risk of trade war
As indicated by the Biden transition plan, the president-elect wants to prioritize pandemic control and reviving the U.S. economy. However, in the scenario where the Republican Party controls the Senate, UBS U.S. economics team expects only a modest fiscal stimulus package.

As a result, they expect slightly weaker U.S. GDP growth of 2.9% in 2021. Meanwhile, the risk of U.S. imposing additional tariffs on imports from China and other countries will likely be significantly lower in 2021, which should help reduce business uncertainty and be positive for global trade.

No unwinding of current tariffs soon
Given the bipartisan support in the U.S. for hawkish stance on trade with China and Biden’s likely focus on domestic issues initially, we do not expect the new U.S. administration to unwind current higher tariffs on Chinese exports soon. Nor do we expect any major changes to other existing U.S. policies on China in the near term.

Nevertheless, as indicated by key Biden advisors, the new administration is likely to take a more deliberate and multilateral approach to trade disputes. This means that U.S. trade policies may become more rules-based and more predictable, which should help lower risk premium in the market.

A comprehensive approach
It seems there is consensus among U.S. political establishment that China is a strategic competitor. According to key policy advisors to President-elect Biden, the new administration may take a comprehensive and strategic approach to U.S.-China relations. Consequently, the Biden administration is likely to maintain a tough political stance on China, keep tight restrictions on China’s access to advanced technology, and work to bring more jobs back to America.

Meanwhile, Biden may be more open to cooperation with China on global challenges of pandemic control, climate change, and non-proliferation. We expect the Biden administration to re-establish formal communication and dialogue mechanisms with China sometime down the road, perhaps along with or after repairing relations with allies.

Trade deal implications
The phase one trade deal has held up so far in 2020 despite the challenges from Covid-19 and worsening of U.S.-China relations in other fronts. Given that the numerical import targets in the trade deal have become even more unrealistic, we think China would want to renegotiate the deal. Meanwhile, the new U.S. administration may want to renegotiate to push for more structural measures in China regarding IP protection and level playing fields.

As such, we expect the two sides to engage actively in 2021, but any new deal is unlikely to be reached until end 2021 or in 2022. Before that happens, we do not expect a reduction or removal of existing U.S. tariffs.
We expect China’s GDP growth to rebound to 7.5% in 2021. As outlined in our scenario analysis, in the case of a Biden presidency with a split Congress, we think the impact of a slightly weaker U.S. growth on China will be offset by a slightly better global trade environment, leaving little net impact on growth in 2021.

As economic activities recover further in China, we expect domestic consumption to rebound significantly, supported by robust exports amid a global recovery. We see much of China’s tax and fee cuts expiring at end 2020 and infrastructure investment to slow modestly in 2021. We expect no change in policy rates but a slowdown in credit growth as the authorities renew focus on containing financial risks.

**Short-term risks**

Before the new administration takes office on Jan. 20, President Trump and the current U.S. administration can and may still implement additional measures against China. Such measures are highly unpredictable and could lead to market volatility.

These measures could include forcing some Chinese companies to delist from the U.S. market, expanding the entity list or list of products that face export restrictions, additional geopolitical provocations, imposing additional sanctions related to Hong Kong and Xinjiang, and more visa restrictions affecting bilateral exchanges and communications. Some of the measures may be politically difficult for the next U.S. president to reverse or unwind, inflicting lasting damage to bilateral relations.

In the case of additional measures against China under the current U.S. administration in the next two months, the yuan may weaken against the dollar. However, after the new administration takes office and global uncertainty declines in 2021, we expect the yuan to appreciate again, in part helped by a weaker dollar.

China’s attractive yields and continued financial market opening should help attract portfolio inflows, even as the current account surplus is projected to shrink. We expect the yuan-to-dollar rate at end-2021 to be around 6.5 partly to reflect PBOC’s increased tolerance for a stronger yuan, though the exchange rate is likely to fluctuate in a wider range than before, breaking 6.5 at times.

We expect the two sides to engage actively in 2021, but any new deal is unlikely to be reached until end 2021 or in 2022. Before that happens, we do not expect a reduction or removal of existing US tariffs.
After four years of Donald Trump changing everything in U.S. trade policy completely, Joe Biden will put things back to order amidst large-scale chaos.

The unilateral protectionist trade policy is one of the typical characteristics of Trumpism, and the type of trade policy Biden will implement has attracted much attention. However, in contrast to Trump, Biden did not make trade policy an important issue during his campaign. From the policy plan released by the Biden team and voices from various channels, he did not propose specific and systematic policies regarding trade. He only discussed topics related to trade policies, such as leading the global “democratic world,” “returning manufacturing industries,” and “protecting workers’ rights.”

Biden is generally believed to be a representative of the Democratic establishment and his policy propositions have inherited the liberal traditions the Democratic Party has upheld for a long time.

In a March 2020 Foreign Affairs magazine article, Biden pinpointing that a government under his leadership would quickly take measures to renew the United States’ democracy and alliances and “have America lead the world again.” He openly criticized Trump’s trade policy saying he “launched an unwise trade war that harmed both U.S. allies and the American middle class.”

Given Biden’s own statement and the Democratic Party’s campaign documents, a “return to tradition” will be a major feature of his administration’s trade policy. Although the trade policy on China has received the most attention, it actually involves more complex diplomatic and strategic issues. How the Biden administration formulates policies toward the WTO and CPTPP is equally important as a better reflection of his trade policy direction.

The WTO, established under the leadership of the United States, is one of the three props of the post-war international economic system. Although the Obama administration expressed dissatisfaction with the WTO, especially repeated claims that the Doha Round was dead and seeking to negotiate a giant regional trade agreement, it never gave up on the WTO leadership or took subversive measures.

Trump adhered to his anti-establishment and anti-globalization concepts and dealt the WTO a fatal blow. He not only threatened to withdraw from it many times, but also initiated unilateral tariffs that undermined its authority. He also paralyzed the WTO Appellate Body, obstructed the smooth appointment of a new director-general, and severely disrupted its normal operations.

It should be said that there are deeper reasons for the United States’ dissatisfaction with the WTO. The current WTO system has difficulty in meeting the interests of the United States, but the Trump administration’s actions have been counterproductive, with no substantial improvements on safeguarding its interests.

For Biden, it is quite easy to set things right on WTO issues, with immediate results. Regarding the issue of the Appellate Body, the restoration of the appointment of its judges will not cost the United States anything, and it can repair the rift with the EU on this issue.

In the appointment of a director-general, an African-American appointee can perfectly fit the Biden administration’s policy of supporting globalization and racial equality.

Although WTO reform still involves more difficult and complicated matters, if the Biden administration can quickly take positive measures on the issue of the Appellate Body and the director-general, it will create a good atmosphere for WTO operations and future negotiations.

The Biden administration has clearly outlined a strategic proposition to return to multilateral order and re-uniting with allies. Returning to the CPTPP is also a potential policy option, especially given that the TPP was negotiated during Biden’s term as vice president.

However, compared with the WTO, returning, or more accurately joining the CPTPP, involves
more variables. The current U.S. trade policy stance has changed a lot since the TPP was concluded four years ago.

Although the finalization of the TPP was a political outcome under the leadership of the Democratic Party, Hillary Clinton proposed its abolition during the 2016 presidential campaign. As for a TPP plan, the Democrats are hardly firm in their position.

Moreover, the anti-globalization sentiment in the United States will not disappear with the end of Trump’s term. The Republicans and Democrats are evenly matched in Congress, and political confrontation is still fierce. The probability of the CPTPP being passed by Congress is very small.

But setting aside the uncertainties caused by U.S. political factors, returning to the CPTPP also requires technical feasibility. In general, there are two potential options for the United States to return to the CPTPP: one is to join the current CPTPP, and the other is to renegotiate with it and even restore the text of the TPP agreement.

The former option will win the support of CPTPP members, but the United States may find it difficult to accept the text of the rules of the existing agreement. For example, the rules of origin of the CPTPP are much looser than the United States–Mexico–Canada Agreement and do not include the property rights and investment rules which concerned the United States in the TPP.

In addition, the United States, as the world’s largest economy, has an economic output far exceeding the total output of the 11 CPTPP members. Joining existing free trade agreements in a passive way is not in line with how the United States positions itself.

The latter option will face great resistance from CPTPP members. A renegotiation of the agreement requires a huge investment of political capital and may also trigger domestic disputes. As for the original TPP agreement text, both the United States and other member countries have abandoned some of the provisions in trade agreement negotiations. The possibility of resuming the original TPP agreement text is almost zero.

Therefore, no matter which path the United States chooses to return to the CPTPP, it will face a very complicated negotiation and debate process. It is highly unlikely that Biden will complete this mission in his administration.

Nevertheless, this does not mean the United States will not use its return to the CPTPP as a tool against China.

Through negotiating with or joining the CPTPP, the United States can attract some parties to the U.S. persuasion and influence their relationship with China. Even if the U.S. fails to return to it, the CPTTP can still serve as a strategic means to drain China’s external development potential.
Reform Could Offer Way Out of CPTPP’s SOE Rules

If reforms continue, Beijing could dramatically reduce the number of state firms that meet the trade agreement’s definition

The Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) trade agreement, while containing rather strict disciplinary requirements for state-owned enterprises (SOEs) in its Chapter 17, also limits their scope in several ways. In addition to the exceptions and exemptions, the definition of SOEs is an important part of the delimitation of the scope of application. If China continues stepping up its efforts to reform SOEs in fully competitive sectors, the number of enterprises that meet the CPTPP’s definition of SOEs could be reduced dramatically.

“Commercial activity”

The definition of an SOE in the CPTPP contains three elements. First, it must of course be an enterprise. According to Article 1.3 of the agreement, an enterprise is any legally established or organized entity, including corporations, trusts, partnerships, proprietorships, joint ventures, associations and similar organizations, regardless of whether they are established for profit or whether they are privately or governmentally owned and controlled.

China’s regulations for registration of business entities do not include the definition of “enterprise,” though the CPTPP’s definition should be broader than that in China as “associations or similar organizations” are not usually registered as enterprises in China.

According to Article 17.1 in the agreement, the SOE must be the enterprise that is “principally engaged in commercial activity,” the second element to define an SOE.

The commercial activity in this article refers to three meanings:
• the enterprise engages in the activity for profit
• engaging in that activity yields the production of a good or service and selling that good or service to consumers in the relevant market
• the quantity and price of the sale are determined by the enterprise

With regard to “orientation towards profit-making,” footnote 17.1 specifically clarifies that the enterprise activity cannot be classified as commercial unless its operation is based on the principle of “not for profit” or “cost recovery only.” However, it is still unclear what “not for profit” and “cost recovery only” mean and how they are defined.

The principle of “not for profit” can be interpreted in two ways. The first is in line with the standard definition of a nonprofit organization as one that makes a profit but does not distribute it. The second is that it does not seek to make a profit, but only to cover costs or not to lose money.

Footnote 17.1 is more than likely to mean the second. If this is the case, since the so-called “cost
recovery” does not include the cost of equity capital, such firms would in fact be subsidized by state shareholders. If they compete in the same market with those who conversely have to provide a market-level rate of return to shareholders, it would be unfair for the latter.

Moreover, according to the above definition of commercial activity, enterprises that cannot decide on the quantity and price of their sales themselves should not be considered SOEs either.

However, in the case of exempted SOEs, some are treated as SOEs even though their selling prices are controlled by the government (e.g., Vietnam Electricity Group). This needs clarification.

Enterprises that engage in activities not to sell goods or services to consumers in the relevant market cannot be counted as SOEs under the CPTPP definition either. It is not clear, however, which activities meet this definition. Perhaps such a situation does not exist.

The above definitions could certainly be exploited. If a government does not want one of its SOEs to be subject to the rules, it can claim the enterprise is “not for profit,” but only “for cost recovery,” or that it sells goods and services in quantities and at prices determined by the government, thereby making it no longer an SOE according to the CPTPP’s definition.

However, the CPTPP’s transparency rules and dispute settlement mechanisms are suspicious about the list of SOEs that the other party country releases. It can ask the other party to provide relevant information and explanations, and if it believes that the other party has violated the contract it can file a lawsuit.

**State-owned and state-controlled**
The third element of the CPTPP’s definition of an SOE is government ownership and control. However, instead of directly using the general concept of “ownership and control through ownership” (which is common in U.S. FTAs with other countries), it specifically lists three scenarios.

Namely, under the CPTPP, an enterprise is an SOE if it is primarily engaged in commercial activity under one of the following three conditions:

- the government directly owns more than 50% of the equity capital in the enterprise operation
- the government, through ownership interests, controls more than 50% of the voting rights
- the government has the right to appoint a majority of the members of the board of directors, or equivalent, of other governing bodies.

In the second condition above, it refers to a complicated case of using ownership interests. For example, if the government directly owns 20% of the voting rights in an enterprise, a
state holding company wholly-owned by the government owns 20% of the voting rights, and a wholly-owned subsidiary of the holding company owns 10% of the voting rights, we say the government controls the exercise of 50% of the voting rights “through ownership interests.”

This definition not only applies to the usual situation where business decisions are made by a vote of the shareholders’ meeting and the board of directors, but also takes into account situations in which business decisions are made by an “equivalent” management body.

In other words, an enterprise that is primarily engaged in commercial activity, if its business decisions are actually in the charge of a management body equivalent to the board of directors, and the government has the right to appoint a majority of the members in this management body, then this enterprise should unquestionably be an SOE according to the CPTPP definition, regardless of how many state-owned shares it has.

At the same time, this definition of CPTPP implies that an enterprise will not be an SOE and thus not subject to the SOE rules, if it meets the following three conditions:

• no more than 50% of the shares are directly owned by the government
• no more than 50% of all voting power is controlled by the government through ownership interests
• the government has the power to appoint directors who do not constitute a majority on the board of directors (or the members in an equivalent governing body)

In other words, if a party wishes to exempt an enterprise from the rules of Chapter 17 by relinquishing control over it, this definition provides such an option. Inevitably, there is still an undue advantage in the loopholes since the government can control an enterprise even if it is a minority shareholder and does not have a majority of seats on the board of directors. But under the transparency rules, either party can require the other party to disclose a special shareholding, special voting rights, or other interest in an enterprise.

**Significance to China**

There is neither any official authoritative interpretation of the CPTPP’s definition of an SOE, nor indications of how parties apply it to their own SOEs. If the above interpretations are sound, it at least will have an influence on China in two aspects.

First, an SOE in a fully competitive sector can be free from the CPTPP rules if it intensifies its reform in the given direction and is thus no longer under the CPTPP’s definition of an SOE. According to the document issued by the CPC Central Committee and the State Council in May 2020, the direction of reform for SOEs in fully competitive sectors is to strengthen the revenue function of state-owned capital. This may include capitalization, securitization, preferred shares, and key employee shareholding.

Following this direction, state-owned shareholders can focus on pursuing the rate of return on state capital in accordance with the financial shareholding principle, and gradually retire as minor shareholders and no longer hold majority ownership, controlling voting rights, or appoint a majority of seats on the board of directors or the equivalent management bodies.

If this were to happen, these companies would no longer meet the CPTPP definition of SOEs. Such enterprises will not be counted as current “state-owned or state-controlled enterprises” but separately classified as “state-invested enterprises.”

Certainly, even SOEs in fields other than full competition, including state-owned financial institutions, can also be transformed into state-invested enterprises, as long as they meet the conditions and do not require state ownership.

Secondly, SOEs that serve government policy objectives and engage exclusively or primarily in business in the public interest can be clearly defined as “not for profit” entities and are not subject to the CPTPP rules.

According to a 2015 document released by the State-owned Assets Supervision and Administration Commission (SASAC) on the classification of SOEs, the definition of public interest SOEs is “to protect people’s livelihood, serve the community, and provide public goods and services as the main objectives, and the price of necessary products or services can be regulated by the government.”

This definition can be further interpreted as “not for profit,” with the quantity and price of output controlled by the government. It also clarifies the exact meaning of “not for profit,” the methods of evaluating the performance of these enterprises, and procedures for entering and exiting this category.

The system needs to be regulated. In addition, as I mentioned in my previous Caixin column, it is worth studying whether such enterprises should be directly converted to public institutions or have their SOE status withdrawn, because in China there is already a distinction between public institutions and SOEs.

However, it is true that not all “public interest SOEs” can be free from the CPTPP’s definition
of SOEs. Still, there is no public information on this yet. While some enterprises, such as those providing urban public services, are certainly in the category, there is a need to further limit the scope.

As noted earlier, if an SOE is allowed by the state to seek cost recovery rather than profit, it is in effect receiving a subsidy from state shareholders. If such an enterprise competes in the same market as one that must provide a market-level rate of return to its shareholders (including enterprises in other countries), it is unfair to the latter.

Therefore, the concept of “public interest SOEs” must not be abused. It is important to prevent some enterprises from using the public interest as a pretext to free ride while gaining from unfair competition in the market.

Compared with the total number of SOEs, the number of enterprises that can be defined as “not for profit” is definitely small. However, the majority of SOEs are likely to be in fully competitive fields, and if the above reforms could be implemented, the number of Chinese SOEs defined by the CPTPP should be significantly smaller than the current number.

As to how small it would be depends on how the “fully competitive sector” is defined and how many of these SOEs could be converted to state-invested enterprise, the rough picture of which can be drawn from the Ministry of Finance’s SOE statistics.

If China continues stepping up its efforts to reform SOEs in fully competitive sectors, the number of enterprises that meet the CPTPP’s definition of SOEs could be reduced dramatically.

For example, the total number of nonfinancial SOEs (state-owned and state-controlled) in 2018 was 203,000, of which 22,000 alone were in the real estate sector. If 90% of SOEs in the real estate sector could be converted to state-invested enterprises, the total number of enterprises under the CPTPP’s definition of SOEs could be reduced by 10%.

If the construction, wholesale and retail, restaurant, social services, and scientific and technological services were also considered fully competitive sectors, and 90% of the 90,000 SOEs in these sectors were converted to state-invested enterprises, the total number of firms under the CPTPP’s definition of SOEs could be reduced by another 40%.

Considering that there are still about 40,000 SOEs in extractive industries, manufacturing, and agriculture, forestry, animal husbandry and fishery, most of the 203,000 SOEs may no longer qualify as SOEs as defined by the CPTPP if these reforms are implemented.
Whatever views we have about what the post-Covid world will look like, and there are many, one thing for certain is that the crisis will have accelerated the digitalization of our planet, a digitalization we knew about but which is again influencing international exchange.

We’ve moved progressively year after year in human history from exchanging goods to exchanging services. And in modern times, to exchanging data. This is a historic, extremely fast transformation and might obviously be difficult to track.

As the value of production systems moves from artifacts, things we make, to intangible things, which relate to information, the difference between a book and an e-book is a very difficult question to answer.

Yet we know that this flow of data is the main characteristic of the new reality we are in, even if how data transforms in euros, in dollars, or in yuan, remains, to be frank, a bit mysterious.

I have my doubts whether this new phase of globalization, data-driven international exchange, will remain as open as the previous wave of globalization.

For the past 30 or 40 years, we’ve known about a huge increase in international exchange because of openness, a phase which had mostly to do with protectionism, that is protecting people from foreign competition, protecting producers from foreign competition.

In my view, we’re moving now to a totally different game, which is coping with what I call precautionism, as opposed to protectionism. Protectionism protects producers from foreign competition, precautionism protects people from risks of various kinds, whether they be safety, security, health, or environment.

This is the new frontier of international exchange, regulation and openness. This is not unknown. For quite some time we’ve been adjusting regulatory standards, for safety, security, certification, pesticides, qualifications for nurses, and car emissions, etc. Yet, the world of data raises much more challenging issues.

As obstacles to trade in the world of data stem from different collective preferences about precaution, they translate into discrepancies in levels and administration of precaution. It becomes a sort of patchwork that hampers economies of scale, and risks increasing the north-south digital divide which we already know is a problem.

So, the word of digitized international exchange will not be as open as the previous world of international exchange. Because digitalization is a case in point of precautionism, given the wide array of safety and security concerns related to exchanging data.

The differences in the way countries see safety and security precautions in data, or about infrastructure, telecommunications, internet, and data regimes, are about addressing cyber vulnerabilities.

This triggered an international conversation many years ago. The first WTO work program dates back to 1998 and has moved in the World Trade Organization into a negotiation, which is now going on.

But we’ve also seen other forms of trade relations, such as bilateral trade, entering into this issue of “how do you create the necessary rules so that trade can remain open?”

We have a rather strong disposition in this respect with the CPTPP in the Pacific region, we have a set of principles in the recently adopted RECP, and we have quite a lot of bilateral agreements, starting with what Singapore has launched with many countries, which are specifically devoted to opening trade in the digital area.

Now if we look at where we are in this international conversation, what I see is a few convergences and quite a lot of divergences.

We have a few convergences in areas like electronic contracts, online consumer protection, authentication of signatures, and in areas like payment safety.

On the other side, we have a lot of divergences on issues like data circulation localization, privacy protection, fiber security, internet neutrality, and
software source protections where the preferences of countries diverge a lot. This is something which is here to stay.

In my view, these divergences are unlikely to be resolved in a level playing field comparable to what we had in the previous phase of globalization with goods and services.

And the reason why these divergences are unlikely to be resolved is because they relate too deep political, philosophical, cultural, and cognitive differences which are at the root of the differences in collective preferences.

What I see is a triangle with three very different systems: a U.S.-driven system, a China-driven system, and a European Union-driven system.

The U.S. system is one where the ideology, the basis of regulation, is that data is merchandised and is what you can soon exchange at a price. The Chinese system is very different. It's one where data roughly is under state control.

And the EU system is one in which data is sort of a part of an individual, the part which people individually possess and is their property. Hence, this huge attention to data privacy which has led to the EU stance on the protection of personal data, the famous General Data Protection Regulation, which is now in force and imposes specific standards on people operating in or with the European Union.

This triangle is unlikely to shrink to a single point, and this is my last point, which is why we need to avoid an excessive fragmentation. We should not aim at convergence; contrary to the past, we should aim at organizing a proper coexistence.

There are three possibilities to get us there.

The first is through a medium which combines some single and valuable geometry for a digital rules-based change system in a pyramid shape. It has a large ground floor with least common denominator commitments for as many countries as possible and then moves upwards to the top for countries accepting a much deeper set of rules and commitment.

A second possibility would be to establish an interface between different systems. This is complex — a combination of two systems with a sort of safe harbor.

And third, is a mutual recognition between systems: you trust that my system could work. You have your system. I have my system. I trust that your system could work. So, we establish a sort of equivalence of two different systems.

So to conclude, I think this digitalization of international exchange raises problems which are much larger than trade and which trade negotiators have a hard time addressing because it's not where I give you something, you give me something, and then we're happy.

The fundamental challenge of globalization in this coming phase of data-driven globalization is to find the right balance between competition and cooperation. And it is also about reinventing new rules for globalization. So, I hope that collectively we will be wise enough to address it so that this world of data does not fracture.
Avoiding China-U.S. Ideological Rivalry

Keeping ideology out of China-U.S. strategic competition will help to prevent proxy wars.

U.S. Secretary of State Mike Pompeo delivered a speech on July 23, in which he claimed the Trump administration will create an anti-China coalition based on ideology.

The next day, Foreign Minister Wang Yi pointed out during a meeting with his German counterpart that “[s]ome anti-China forces in the U.S. lately have been deliberately creating ideological confrontation ... China still hopes to achieve no conflict, no confrontation, mutual respect, and win-win cooperation with the U.S. ... China will neither dance to the U.S.’ tune nor let the U.S. have its way.”

Hence, the strategic significance of preventing the China-U.S. ideological rivalry from intensifying, and specifically how this can be prevented, is worth discussing.

The rise of China has challenged the United States’ aim of maintaining its hegemony, resulting in inevitable strategic competition between the countries.

However, where the countries should compete and where they shouldn’t is an important strategic decision. Competition in some fields — such as science and technology, economy, military, diplomacy, and education — will decide the success of China’s national rejuvenation and is therefore necessary.

On the contrary, engaging in ideological rivalry will have a negative impact on China’s rejuvenation. Therefore, avoiding ideological rivalry has become a strategic principle of the Chinese government since the early 1980s when reform and opening up were gaining momentum, and is significant in multiple ways.

First, avoiding this kind of competition maintains an international environment favorable to national rejuvenation in the long term. The Communist Party Central Committee issued the Resolution on Certain Questions in the History of Our Party Since the Founding of the People’s Republic of China in 1981, summarizing the historical experience and lessons since the founding of the People’s Republic. The most important diplomatic lesson is to avoid ideological rivalry with other countries.

The resolution states: “The road of revolution and construction suited to the characteristics of a country has to be explored, decided on and blazed by its own people. No one has the right to impose his views on others. Only under these conditions can there be genuine internationalism. Otherwise, there can only be hegemonism. We will always adhere to this principled stand in our international relations.”

Following the principle of avoiding ideological rivalry, our country has won strategic opportunities over more than 30 years of peaceful construction. This principle was further embodied in 2017, when the government asserted it “will not ‘import’ a foreign model, nor ‘export’ China’s model, and will not require other countries to...”
Second, it reduces political obstacles to international cooperation. The principle of avoiding ideological rivalry has secured long-term strategic opportunities for the rise of China, because the principle helps our country avoid political obstacles caused by ideological rivalry to international cooperation.

For example, in 1989, Western countries headed by the United States imposed sanctions on China for ideological reasons. In response, Deng Xiaoping met with former U.S. President Richard Nixon and told him: “When considering relations between states, we should mainly proceed from our national strategic interests, focusing on long-term own strategic interests and respecting that of the other. We should not raise a great fuss about historical grievances, or about differences in social systems and ideology.” Since China insisted on avoiding ideological rivalry, the relationship between China and Western countries was restored in 1993.

Third, it strengthens international strategic credibility and maintains the stability of strategic relations. Avoiding ideological rivalry means that China’s basic stance on cooperation with any country will not change because of the changes in the other side’s political system or ideology.

Maintaining the continuity of policies can enhance China’s international strategic credibility, thereby maintaining the continuation of cooperation. For example, in the late 1980s, Gorbachev, then general secretary of the Central Committee of the Communist Party of the Soviet Union, proposed liberal “new thinking” and carried out shock therapy reforms, which is different from China’s socialist reform approach.

Responding to that, Deng Xiaoping proposed: “No matter what happens in the Soviet Union, we should calmly develop our relations with it on the basis of the five principles of peaceful coexistence. That should include our political relationship and we should not hold any debate on ideology.”

In 1991, after the dissolution of the Soviet Union, Boris Yeltsin reformed Russia’s political system. In this regard, China consistently stuck to the principle of avoiding ideological rivalry, which contributed to Yeltsin’s four visits to China during his tenure as president. This did not only maintain the bilateral strategic cooperation but also put forward the establishment of the “Shanghai Five” forum mechanism in 1996, which developed into the Shanghai Cooperation Organization in 2001.

Fourth, it prevents a new cold war and proxy wars. The Cold War between the United States and the Soviet Union was mainly carried out through proxy wars, with the nations supporting forces with the same ideology as their own in third countries. The Chinese government clearly understands the danger of a new cold war also caused by ideological rivalry, and points out: “The U.S. Secretary of State Pompeo delivered a speech a few days ago, trying to trigger ideological rivalry and lead the world to a new Cold War.”

If a new cold war happens, a large number of proxy wars will be carried out. This will not only bring great difficulties to China’s rejuvenation but may even risk ending the rejuvenation. Restricting China-U.S. strategic competition outside of the ideological realm will help to prevent China-U.S. proxy wars caused by ideological rivalry.

The Chinese government has made it clear to the international community that the United States “deliberately provoked ideological rivalry” and “China will not be drawn in by the few anti-China forces in the United States.” When China puts this position into specific policies and actions, it will disrupt the U.S.’ strategy to provoke ideological rivalry. Since the U.S. deliberately provoked ideological rivalry, China can only take unilateral action to prevent it from leading to a new cold war.

**Do not engage in ideological rivalry**

There are currently more than 200 political...
entities in the world, and very few have ideologies and political systems similar to China’s. Under these circumstances, avoiding ideological rivalry will be more beneficial than harmful to China.

Since the U.S. is deliberately provoking ideological rivalry, it will inevitably point its finger at China’s internal affairs. Faced with the reality that a large number of countries in the world adopt ideologies and political systems similar to those of the United States, China should maintain its current practice of not responding or otherwise dancing to the U.S.’ tune in the current China-U.S. ideological conflict, for the sake of undermining the United States’ effort to make an anti-China coalition under the excuse of ideological differences. In ideological conflicts with other countries, China needs to adopt an inclusive strategy, and take the initiative to resolve any differences and conflicts.

**Do not criticize other countries**

In response to the ideological differences between China and the Soviet Union, Deng Xiaoping once suggested: “Don’t criticize others or accuse others casually; don’t speak too much; don’t do too much.” This lesson is also applicable to all countries that engage in ideological conflict with China.

In response to American ideological provocation, the Chinese government stated: “It is both unnecessary and impossible for each side to change the other. Instead, we should respect the independent choices made by the other party.” Since the U.S. is not able change China, China should not worry about the U.S.’s ideological attacks. Meanwhile, China has no intention to change the U.S., so there is no need to criticize the U.S. on human rights or its domestic policies.

This approach can also be applied to other countries that have ideological differences with China. Thus, we can make it so the ideological provocations of others amount to nothing, simply by not responding.

**China’s external publicity**

China has always advocated: “All countries and the people of all countries should enjoy dignity. The sovereignty and dignity of all countries, whether big or small, strong or weak, rich or poor, must be respected; their internal affairs must allow no interference; and they have the right to independently choose their social system and development path. As the old saying goes, you can’t know if the shoes fit until you put them on. Only the people of a country can comment on whether their country’s development path is appropriate or not.”

As China’s economic recovery and pandemic containment are better off than other countries, choosing not to compare the effects of different political systems has an even greater significance. This not only shows China’s respect for the autonomy of other countries in choosing their own political systems, but also avoids stimulating anti-China sentiment in other countries. In order to strengthen friendly relations between China and other countries, related governmental departments must respect the different political systems of other countries, and suppress the arrogance of belittling the political systems of other countries.

**Promote the peaceful coexistence**

The white paper China’s Peaceful Development, published in 2011, stated: “Dialogues and exchanges among civilizations should be encouraged to do away with ideological prejudice and distrust, and make human society more harmonious and the world more colorful.”

Human thinking is very diverse, and it is impossible to eliminate ideological differences between countries. Therefore, in order to prevent ideological differences from negatively affecting China’s foreign relations, related governmental departments should strictly implement the principle of avoiding ideological rivalry, and establish institutional confidence based on the logic that only our system is suitable for China’s development.

In 2011, Hu Jintao, then the general secretary of the Central Committee of the Communist Party of China, pointed out: “The socialist system with Chinese characteristics is the fundamental institutional guarantee for the development and progress of contemporary China, and it embodies the characteristics and advantages of socialism with Chinese characteristics.”

In other words, we firmly believe that the Chinese system can bring progress to China, but we do not assume that foreign systems are inferior. In order to strengthen friendly relations between China and other countries, we must respect the different political systems of other countries and restrain the arrogant mentality that demeans their political systems. The cultural tradition of self-confidence in China is “not to reach out to teach, but also not to reject the one who comes to learn,” which means that we do not try to export our ideology or political system, but we also do not hide them from those who want to learn from us.

Government departments must firmly implement the central government’s policy of avoiding both ideological rivalry and the export of political systems, which can differentiate China’s stance on ideological differences from that of the U.S., while at the same time effectively avoiding a new cold war.
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