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## China moves to reassure international investors and banks after EdTech crackdown



China's market watchdog, the China Securities Regulatory Commission (CSRC), convened with representatives from global investment banks and investment firms on Wednesday evening in a bid to ease concerns after tough new restrictions on private education companies catalyzed a strong market sell-off. News of the meeting calmed markets which recovered part of their recent decline.

As we <u>wrote</u> yesterday, Beijing unexpectedly unveiled new regulations that forbid Chinese companies engaged in teaching school curriculum subjects from raising capital, listing on global stock exchanges and from accepting foreign investments. The move – which follows an antimonopoly campaign targeting big tech names and a revision of IPO rules for groups seeking to list in the US – left international investors fearing a broader crackdown on foreign investment in Chinese companies.

At the meeting, the CSRC sought to restore investor confidence and reassure attendees that China has no intention of decoupling from global markets – particularly that of the US. The Vice Chairman of the CSRC, Mr. Fang, told the group that foreign capital is a strong tenet of China's current and future policy objectives and that improved communication and transparency could be expected moving forward. Moreover, he added that policies will be paced in a more gradual manner, in that they are better digested by the market.

One particular concern for foreign investors was that the VIE (variable interest entity) structure may be in jeopardy. VIEs are a popular avenue for Chinese firms wishing to list in the US, while bypassing rules restricting foreign investment in sensitive industries. The VIE mechanism rose to prominence in 2000 and has been used by China's homegrown tech behemoths like Alibaba, JD.com, Baidu and Pinduoduo (the largest agriculture-focused technology platform in China) to access foreign capital. In turn, foreign investors can share in their profits, but they do not technically own any part of the actual underlying company. Under the new regulation, education tech companies will be prohibited from using the VIE structure and investors now fear that VIEs in all sectors could face more stringent regulation. Mr. Fang said that the VIE structure continues to be viewed as a necessary and important tool. He added that more policies conducive to foreign and private capital may be in the works.

After the CSRC's meeting with big banks, the blue-chip CSI 300 index closed almost 2% higher (but was still down 4.7% on aggregate), while the tech-focused ChiNext index finished the day up more than 5%, recouping nearly all of the week's losses.

Looking ahead, we cannot say that scrutiny of big tech – a global phenomenon - will subside. However, we believe that the worst-case scenario crackdown on the private education industry was isolated to this specific sub-sector as China tries to address social issues, and should not be over extrapolated, even if regulation is getting tighter for other areas as well.

In all, we still see the investment case for China as valid and believe in the fundamentals on the ground that underpin our convictions. However, foreign investors should not be complacent about the political risks involved. Investing in China should be viewed as a marathon, not a sprint. Indeed, policy risk is higher in this market, and there will be these moments of volatility, but as of now, we don't think this should distract from the attractive mid-to-long-term opportunities offered by China's innovative and growing economy.

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