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Ant Financial (D)

In February 2018, Alibaba Group Ltd. became one-third owner of Ant Financial Services Group (Ant), seven years after spinning off Ant's digital payments app Alipay.[1] In June 2018, Ant raised $14 billion in its third round of funding in three years, giving it a valuation of $150 billion.[2] For the first time, foreign investors were allowed to buy shares, and it was expected that the company would go public within a few years.[3] Ant said it would use the funds to extend its global footprint, and in February 2019, it paid $700 million for WorldFirst, a London-based currency exchange provider that facilitated money transfers around the world (after failing to acquire a similar U.S.-based company, MoneyGram, in 2017).[4]

Around this time, Ant approached commercial banks in China with an offer to match them to potential borrowers through its digital consumer lending services, Huabei (Ant Credit Pay) and Jiebei, launched in 2014 and 2015, respectively. Huabei, which means "just spend," was a virtual credit card that allowed users to borrow money interest-free for 40 days through Alipay—extending credit to many who did not qualify for a bank-issued credit card.[5] Jiebei, which means "just borrow," offered consumer microloans for personal use that could be repaid over 12 months in installments.[6] Ant asked the banks to put up the capital for the loans, and in exchange, Ant provided basic information about the borrower, assessed the borrower's credit risk, and channeled funds back to the banks.[7] Ant and the lender would agree on the amount to be loaned; borrowers could then be approved in minutes through their phones. However, Ant kept banks in the dark about how it assessed borrower risk, and the banks bore the risks of default.[8] Ant collected a fee of 30% to 40% of a loan's interest income.[9] The annualized interest rate for most loans was 14.6% (and as high as 18.25% in some cases).[10] Around 100 banks, from small regional banks to large national banks, partnered with Ant, providing a growth engine for the company.[11]

In August 2019, a report noted the rising levels of household debt in China was fueled by the appetite for consumption among its younger generation and aided by the ease of borrowing money, mainly through Huabei. By then, Huabei had extended loans worth more than $140 billion.[12] A young Chinese consumer admitted, "Huabei is 'truly addictive,' [. . .], 'It gives me an illusion that I'm not really spending my own money.' [She] says she's scaling back some now because of higher living costs

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and because she's reluctant to keep turning to her father for money."[13] Most Huabei users were under 30, and in December 2019, the average outstanding balance on Huabei's lines of credit was $142.[14]

The company made $2.5 billion in profit in 2019 and $3.2 billion in the first half of 2020.[15] Ant had already repositioned itself as a "techfin" company instead of a fintech company. In June 2020, it rebranded as Ant Group to reflect its role as a technology provider to businesses, including financial organizations.[16] Shortly after changing its name, Ant announced plans to go public.[17] It held about $333 billion (or 2.15 trillion yuan) worth of consumer and small business loans, against $2.5 billion (or 16 billion yuan) in authorized capital.[18] In contrast, more than 4,000 of China's commercial banks held just six times as much in outstanding loans at the time.[19] The company also reported that Alipay had more than one billion users generating $17 trillion worth of transactions.[20] Ant had extended $263 billion in consumer loans to 500 million people, but only funded 2% of the total.[21] In July 2020, Ant reported that nearly 3% of outstanding consumer loans were 30 days overdue, and 2.2% were more than 90 days overdue, a ratio similar to commercial banks.[22]

During the three months ended in September 2020, Ant had contributed $2.3 billion in profit to Alibaba, whose total profit during the same period was $3.9 billion.[23]

In the fall of 2020, China moved to regulate its tech industry, releasing rules on microlending that applied capital requirements to technology companies and drafting laws to tighten protections on user data.[24] (See **Exhibit 1**.)

On October 21, 2020, Chinese regulators cleared the way for Ant's IPO in November.[25] Observers expected the company to raise $34 billion, at a valuation of $310 billion, in a dual listing on the Shanghai and Hong Kong stock exchanges.[26] On October 24, 2020, Ant's majority shareholder and Alibaba's founder, Jack Ma, made a speech that was critical of the Chinese regulatory system: "We cannot regulate the future with yesterday's means. There's no systemic financial risks in China because there's no financial system in China. The risks are a lack of systems.[27]

The reaction to Ma's speech was swift and severe. On November 3, 2020, just two days before it was to be listed, Chinese regulators forced Ant to postpone its IPO—which was on track to be the world's largest.[28] Regulators focused their concern on Ant's consumer lending services and the disproportionate risk carried by smaller banks. One analyst said, "Smaller banks are weaker in risk control. If defaults of the loans originated from online platforms go up, these banks will face bigger losses."[29] Ant's consumer lending business—including Huabei, Jiebei, and Mybank Loan, which serviced loans for small-and-medium businesses—grew nearly 60% in the first six months of 2020 and accounted for nearly 40% of the company's revenue.[30]

It was reported that after years of wielding a light touch in the country's booming tech industry, Chinese President Xi Jinping personally intervened to delay Ant's IPO.[31] One newspaper also reported that China's leadership was concerned about the shareholders who stood to benefit most from the IPO, including some of Xi's rivals.[32]

In December 2020, Chinese regulators made five demands of Ant: return to its payment roots, safeguard personal data in its credit business, set up a financial holding company, improve corporate governance, and exercise more discipline in its securities and asset-management businesses.[33] Regulators also launched an antitrust investigation into Alibaba, questioned executives at Tencent and Pinduoduo, and floated new rules that could govern many tech firms' operations.[34] The new rules would also bring into question the large amounts of consumer data Ant had collected through its digital payments services, which would now come under the eyes of regulators.[35]

At the beginning of 2021, Ant continued to have "massive interests" in online investing, insurance, and consumer and lending; it had $635 billion in assets under management and accounted for over half of China's mobile payments market.[36] In January, reports circulated that Ant would restructure as a financial holding company overseen by China's central bank. As such, Ant would need to have enough money to cover at least 11.5% of their risk-weighted assets (similar to the Basel Accord rules).[37,a] Observers noted that Ant's balance sheet fell short of this ratio.[38] A journalist explained, "The more stringent rules mean the firm may have to raise funds to beef up its capital base, opening a door for big state banks or other types of government-controlled entities to buy stakes. Existing shareholders' stakes could be diluted as a result."[39]

In February 2021, China Banking and Insurance Regulatory Commission formalized rules designed to force online lenders like Ant to bear more risk in their lending practices. Beginning in 2022, online lenders would be responsible for 30% of every loan made with commercial lenders.[40] The rules also stipulated that banks would also be subject to caps on the amount they could loan in partnership with online lenders, a move analysts said was designed to decrease banks' reliance on Internet platforms such as Ant and Tencent Holdings Ltd.-backed WeBank (an Ant competitor).[41] Regulators also curtailed the ability of banks to provide online loans outside of their jurisdiction, which analysts noted would impede the growth of regional banks.[42] Also around this time, a news outlet reported that Ant planned to spin off its credit data operations—with its enormous trove of consumer spending data—to help put its IPO back on track within two years.[43]

In March, Ant's chief executive, Simon Hu, stepped down citing personal reasons, and Executive Chairman Eric Jing became the new chief executive of Ant. Hu would devote his efforts to philanthropic work at both Ant and Alibaba. Ant's valuation by then had fallen to $200 billion.[44]

[a] The Basel Accords, agreed on in November 2010, set guidelines aimed to ensure that financial institutions maintained enough capital in their reserves to meet their obligations and absorb unexpected losses.

Exhibit 1 Summary of China's New Financial Regulations

Effective as of November 2020:

- Firms that operate two or more financial businesses in the country will be classified as financial-holding companies.
- Financial-holding companies need to have registered and paid-up capital of at least 5 billion yuan, equivalent to $731 million. The rules also apply to large businesses whose financial assets, such as loans, comprise 85% or more of their total assets.

Effective in 2022:

- Internet-lending platforms in the country will have to fund at least 30% of every loan they make jointly with commercial lenders, which include banks, trust companies, and finance companies.
- Banks will have to limit their co-lending with any internet platform to 25% of their Tier 1 net capital, while overall online loans they make in this manner cannot exceed 50% of their outstanding loans.
- Regional banks will not be allowed to make loans online to borrowers who live outside of their jurisdictions.

Source: Casewriter compiled from Xie Yu, "China's Online-Lending Curbs to Hit Big Tech Firms and Regional Banks," *Wall Street Journal*, February 22, 2021, https://www.wsj.com/articles/chinas-online-lending-curbs-to-hit-big-tech-firms-and-regional-banks-11613992441, and Stella Yifan Xie, "China's New Financial Rules to Cover Jack Ma's Ant Group," *Wall Street Journal*, September 13, 2020, https://www.wsj.com/articles/chinas-online-lending-curbs-to-hit-big-tech-firms-and-regional-banks-11613992441, both accessed March 2021.

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