PSSI PERSPECTIVES - 28

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Elias Sköld, Project Coordinator, Prague Security Studies Institute

August 16, 2023

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U.S. LEGISLATIVE MOMENTUM AGAINST RISKY INVESTMENTS IN CHINA

In the evolving political landscape of the U.S. capital markets, a compelling narrative is now rapidly emerging, one that reflects a resounding call for increased vigilance and safeguards against burgeoning "China Risk". The proposition on the table is straightforward: *U.S. investors should not be permitted to continue to fund Chinese state-controlled companies, particularly sanctioned corporate "bad actors", as bilateral relations spiral in a perilous direction.* By financially underwriting Chinese publicly traded enterprises which develop and build aircraft carriers, hypersonic glide vehicles and missiles, and other cutting-edge weaponry for the PLA, not to mention are engaged in egregious corporate human rights abuses, Wall Street firms are now recognized by many in Congress to be endangering American democracy, investors and fundamental values, as well as those of its allies. Scores of millions of retail American investors are being subjected to needless, asymmetric material risks and fiduciary malfeasance on the parts of Wall Street fund managers and U.S. government regulators.

In recent weeks, there have been a number of clear indications that bipartisan U.S. legislative momentum and the political will to curtail such investments is growing. Four prominent examples of this push to decouple/de-risk away from such Chinese corporate "bad actors" in the American capital markets are cited below:

BLACKROCK'S AND MSCI'S CHINA INVESTMENTS

BlackRock and MSCI are now under formal congressional investigation due to their involvement in facilitating investments in Chinese corporate "bad actors" in their investment products. The bipartisan letters from the House Select Committee on the CCP dated July 31, 2023 appear here (BlackRock and MSCI). The questions posed are especially rigorous, with answers due this month.

BIPARTISAN SUPPORT GROWS FOR REMOVING CHINESE FIRMS FROM TSP

On July 27, 2023, Senator Marco Rubio (R-FL) led a bipartisan Senate vote of 55-42 to excise Chinese companies from the Federal Thrift Savings Plan (TSP) via Amendment 523 of the National Defense Authorization Act. Although the outcome lacked the 60-vote majority needed for passage, it clearly signals a major political "win" the next time such a vote takes place, given that a majority of the Senate, including the Democrat Chairman of the Senate Banking Committee, support this action.

CHINA'S DECEPTIVE FINANCIAL PRACTICES HIGHLIGHTED

Senator Rubio has continued to push for increased legislative action on China's shadowy and deceptive financial practices. On August 10, 2023, the Senator wrote a letter to SEC Chairman Gary Gensler, voicing concern about China's pressure on firms to conceal material risks associated with doing business there. He urged prompt SEC action to ensure Chinese firms comply with U.S. securities laws and regulations, highlighting a recent Chinese directive curtailing risk-related disclosures and keeping international investors in the dark. Indeed, at this writing, China announced that it was also discontinuing any public reporting on its soaring youth unemployment rate, blinding the markets with respect to yet another key risk indicator. The message is clear: *Continued access of Chinese companies' to American capital markets and private equity without proper and fulsome material risk disclosure is fiduciarily malfeasant and a danger to U.S .investors and national security*.

A NEW BILL TARGETING TAX-EXEMPT ENTITIES INVESTING IN CHINESE COMPANIES

In a further effort to protect the integrity of the U.S. capital markets, Representative Gallagher, Senator Hawley, and other members have introduced a new bill which aims to prevent tax-exempt entities from investing in Chinese companies with close ties to the Chinese Communist Party (*which is all of them*). Such U.S. entities would include state pension funds, college endowments, NGOs, and others.

EUROPE LAGS BEHIND ON "CHINA RISK"

These recent developments reflect a notable shift in American political sentiment concerning the presence and influence of Chinese companies in U.S. capital markets and the private equity market. Wall Street firms which have, to date, defiantly declared, "If it's not illegal, we're doing it", now have to be considerably more concerned about their corporate reputations and brands, not to mention the fact that several of their existing avenues for investing in Chinese enterprises will likely be legislatively shut down one by one for reasons of investor protection, national security and/or human rights abuses in the next 12 to 18 months. This subject was amplified in an August 11, 2023 U.S. national television interview with PSSI Chairman, Roger Robinson.

In Europe, however, these conversations do not appear to be taking place. European lawmakers seem content to allow undisciplined, non-transparent investments by tens of millions of their citizens in thousands of unregulated Chinese companies, a sizable number of which are sanctioned "bad actors". This transatlantic disconnect is unsustainable, particularly given America's preeminent position in the global financial domain. For example, European passive investment products are often those of American asset managers and index providers.

These capital markets deliberations are directly connected, for example, to the EU's supposedly strenuous efforts to protect and safeguard basic human rights and freedoms, beginning with avoiding goods tainted by force labor, the equipping of concentration camps, aiding and abetting genocide, the constructing of a "surveillance state" and other egregious Chinese corporate human rights abuses. Sadly, but factually, a significant number of the Chinese companies engaged in these malign activities are embedded in the investment portfolios of average European investors, and government regulators do not appear to take seriously this glaring policy inconsistency -- as illustrated in an earlier PSSI *Perspective* entitled *EU Faces a Momentous Choice on the Forced Labor Ban*. Clearly, such unwitting investment in the securities of these offending Chinese companies should be strictly prohibited.

European governments must also ensure that their citizens are not unduly exposed financially to a system governed by a capricious and dangerous authoritarian regime. Basic financial disclosure and corporate governance requirements for Chinese companies present in Western capital markets are regularly skirted and virtually always inadequate. The Chinese government has recently criminalized foreign due diligence and market research activities under the rubric of its version of "national security". Under current conditions, it is unconscionable to permit the holding of Chinese securities in the retirement and other investment portfolios of European citizens.

In sum, Europe is falling dangerously behind the U.S. in its efforts to shield itself from such inordinate "China Risk" and the harsh human rights and national security consequences of funding malevolent Chinese corporate activities in Europe and beyond. It would therefore be prudent for European lawmakers and national officials to commit to legislative harmonization with the U.S. on this vital "de-risking" front. The costs of continuing to "stonewall" or ignore this massive, China-related national security, human rights and investor protection portfolio of issues will likely be especially high -- particularly with regard to Europe's reputation and "brand" globally. Worse still, Europe’s financial strength pales in comparison with that of the U.S. Accordingly, Europe would be wise to avoid a transatlantic struggle on this matter and, instead, find common ground for the common good.