China: Recent Developments in the Regulation of Private Placements

By Liza Mark, of Haynes and Boone LLP, Shanghai.

Unlike in the U.S., private placements of securities in China are regulated differently, depending on who is actually doing the private placement.

Historically, private placements of securities in China are sorted into three main categories, and each category is regulated by different agencies with their own rules and regulations:

1) Private placement of securities by publicly listed companies: Regulated by the China Securities Regulatory Commission (CSC).

2) Private placement of securities by private equity funds and venture capital funds (the money raised is intended to be used for investing in other securities): Historically regulated by a hodgepodge of regulators, including the National Development and Reform Commission (NDRC), the CSC, and various local regulators.

3) Private placement of equity securities by non-publicly listed companies: This is a regulatory gray area and no definitive regulation has been set for such capital raising activity.

Recent changes appear to portend a shift towards a more uniform way of regulating capital raising by private placements of securities in China.

On May 8, 2014, the State Council of China released the Several Opinions of the State Council on Further Promoting the Healthy Development of the Capital Market (2014 State Council Opinions), promulgating the requirements laid down at the 18th National Congress of the Communist Party of China (CPC) and the Second and Third Plenum Sessions of the 18th Central Committee of the CPC.

The 2014 State Council Opinions states:

- A private placement system shall be established and improved. It is important to formulate a set of criteria on qualified investors, specify the investor suitability requirements on the private placement of various products and the information disclosure requirements on private placement to the same type of investors, and standardize placement activities.

- No administrative examination and approval shall be instituted for private placement. Instead, issuers of all types are allowed to issue, on the basis of compliance, stocks, bonds, funds and other products to an accumulated number of investors that does not exceed the number specified by laws.

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The administrative examination and approval shall be abolished for private placement. Investors' interests of all types are allowed to make the final decision on whether to invest or not.

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Recent changes appear to portend a shift towards a more uniform way of regulating capital raising by private placements of securities in China.

**What is a 'Private Placement' in China?**

Historically, there has been no uniform definition of what is a 'private placement' in China. The Securities Law, as a central government promulgated statute, for the first time formalized a 'private company' standard. This was a regulatory change that needed to be addressed by the central government. Prior to that, regulations were subject to the form a fund took; whether it was a venture capital fund, an enterprise fund, a private equity fund, or a different type of fund. These authorities have respectively claimed jurisdiction over regulation of different areas of private capital raising, creating often inconsistent and sometimes even overlapping regulatory requirements.

In Beijing, funds were created through registration with the Beijing Municipal Bureau of Financial Work and the Beijing Municipality, and regulated by the Beijing Municipal Commission of Development and Reform. In Shanghai, funds were created through registration with the Shanghai Development and Reform Commission and the Shanghai Municipal Office of Finance Services. In Beijing, funds were regulated by both the Beijing Municipal Bureau of Financial Work and the Beijing Municipal Commission of Development and Reform. In Shanghai, funds were regulated by both the Shanghai Development and Reform Commission and the Shanghai Municipal Office of Finance Services.

These authorities have respectively claimed jurisdiction over regulatory measures under the Administration of Issuance of Securities in China. Private placements of A-share listed companies in China are regulated by different local governments.

To make matters more confusing, private placements of investments to China are regulated by different regulators, including the CSRC, the NDRC, and multiple layers of local government.

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The CSRC has now promulgated the Interim Regulations on the Supervision and Administration of Private Investment Funds ("CSRC Regulations") in August 2014 (see analysis at WSLR, October 2014, page 14) The CSRC Regulations introduced registration and filing requirements, "qualified investor" requirements, and prohibitions of general solicitation. The CSRC Regulations also delegated some of the securities regulation powers to private investment funds to the State Management Bureau of Securities of China ("CSRC"), a self-disciplinary regulatory body for the securities industry.

We expect that the regulatory regime in China relating to private placements across different types of capital formation activities will likely consolidate and move closer to a uniform standard.

**The New Securities Investment Funds Law and the CSRC Regulations**

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as an institutional investor, must have net assets of at least CNY 500,000 (U.S.$81,179), or
as an individual investor, must own financial assets (including bank deposits, stocks, bonds and other financial assets, but excluding real property) of at least CNY 3 million (U.S.$487,077), or have annual income during the preceding three years of at least CNY 10 million (U.S.$1,623,590), or

The CSRC Regulations further list certain institutions as "qualified investors," such as state-owned enterprises, financial institutions, insurance companies, investment funds, social security funds, pension funds, etc. The articles of association or other materials required by the AMAC.

In addition, any form of principal-protected commitments, such as money-back guarantees, minimum returns guarantee are strictly prohibited. Such restriction on general solicitation is very similar to the approach in the U.S. under Rule 506(b) of Regulation D of the '33 Act. Obviously, the newly adopted Rule 506(c) of the '33 Act allows for securities to be sold to 35 other non-accredited investors through general solicitation or general advertising for a legal "private placement." General solicitation is defined to include promoting the fund to non-specific investors through general advertising, such as newspaper or magazine articles, network, or via seminars, colloquiums, posters, short presentations, radio, television, Internet and other public media, etc. The CSRC Regulations do not provide such flexibility.

Furthermore, unlike the CSRC's silence on the verification of an "accredited investor," the '33 Act sets out clear rules and standards with respect to the verification of an "accredited investor." However, the methodologies and standards required to file with AMAC certain information and legal documents relating to the investment fund.

Since the CSRC Regulations are just now setting out the various legal requirements, it will probably take some time before the regulatory landscape in China further streamlines between different types of private placements and the corresponding high level of investor protection that now allows for general solicitation.

Filing Requirements
After each successful raising of money from investors, the fund manager is required under the CSRC Regulations to file a Form D within 15 days after the first sale of securities in the offering.

The AMAC is required to post such filings on its website within 20 working days after all the required record is submitted. Therefore, all the information becomes public.

Conclusion
Although it may still be too early to tell when China will eventually converge all private placement regulations into one modern regulatory framework, but in the U.S. and other mature markets, we are seeing other regula...
tions being promulgated that adopt the above standards when regulating private placements in other capital formation categories.

For example, the CSRC itself recently promulgated the Administrative Provisions on the Asset Securitization Business of Securities Companies and the Subsidiaries of Fund Management Companies, specifying that the offering of privately placed asset-backed securities in China shall also refer to certain regulatory requirements under the CSRC Regulations, including the 'qualified investor' criteria. In addition, the proposed Administrative Provisions on Crowd-funding of Private Equity, which are under public comments, also explicitly adopt virtually the same 'qualified investor' test as in the CSRC Regulations.

Therefore, we expect that the regulatory regime in China relating to private placements across different types of capital formation activities will likely consolidate and move closer to a uniform standard.

In addition, the consolidation of regulation into the hands of a single regulator will also accelerate the development of a comprehensive set of rules governing such activities across the different categories of capital formation activities.

NOTES
1 The NDRC is a department under the State Council of China with primary responsibility for guiding overall economic system reform and macro-control of the country, yet it has turned into one of the biggest and most powerful Chinese bureaucracies in its influence and ability to push its government-oriented preference into every market segment.
2 See Regulation D § 230.506 (b) (2) (ii) Nature of purchasers.
4 A widely used mobile and voice messaging communication service developed by Tencent in China.
5 SEC New C&DIs regarding Rule 144A and Rule 506(c), November 13, 2013, question 206.09.

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