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## China Releases Provisions on Strengthening the Supervision of Private Equity Investment Funds (Draft)

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On September 11, 2020, the China Securities Regulatory Commission (“**CSRC**”) released the **Provisions on Strengthening the Supervision of Private Equity Investment Funds (Draft)** (the “**Draft**”) to solicit public comments until October 10, 2020. The Draft is intended to further strengthen regulation of the private equity investment funds industry. Six years after CSRC issued the **Provisional Measures on Supervision and Administration of Privately-offered Investment Funds (effective August 21, 2014)**, this is the next chapter in the relevant requirements for the supervision of private equity funds in China.

The Draft addresses six major aspects of private equity funds: name, business scope, staff, related party transactions, the duty to raise money only from qualified investors and legal responsibilities. A short summary of the anticipated change that the Draft will evoke includes:

### 1. The registered address needs to be exactly the same as the private equity fund’s office location

Article 3 of the Draft stipulates that the registered address of the private equity fund with the State Administration for Market Regulation (“**SAMR**”) must be in the same city as the business address of the private equity fund. This stems from the popular practice of locating the business team in big cities, such as Shanghai, Beijing or Shenzhen, but keeping the registered address in tax-favorable locations, like Tibet or Xinjiang. The Draft will put a stop to this practice and requires that the registered address of the private equity fund be in the same administrative city as the business address of such fund.

### 2. The fund managers (or general partners) cannot manage other unregistered private equity funds

Article 4 of the Draft stipulates that fund managers (or general partners) shall not manage other private equity funds that have not been registered with the Asset Management Association of China (“**AMAC**”), a quasi-governmental industry body charged with regulating the private equity industry. In practice, many types of private equity funds (such as real estate funds) have historically been unable to register with AMAC and have conducted their business in certain gray areas. It appears that the regulatory authority is looking to further tighten the AMAC registration requirements with the limitations in the Draft.

### 3. Private equity funds can engage in loan and guarantee activities

The **Instructions for the Filing of Private Equity Investment Funds (effective December 23, 2019, AMAC)** (the “**Instructions**”), previously prohibited private equity funds from engaging in loan activities. The Draft appears to allow private equity funds to use investment tools such as bridge loans and convertible bonds.

Article 8 of the Draft clearly allows that, for purposes of equity investments, private equity funds can provide loans and guarantees for investees for less than one year, which is a meaningful clarification of the Instructions. It also negates any concerns for private equity funds engaging in short-term bridge loan investments and convertible bond investments in China.

## 4. Clear prohibition on conflicts of interest investments

Article 9 of the Draft clearly states that fund managers or staff of private equity funds shall not use such fund's assets to directly or indirectly invest in enterprises or projects controlled by such fund's managers, controlling shareholders or actual controllers. Although the Draft did not define this type of "conflict of interest investing," we anticipate that this prohibition will have a material impact on the business model of private equity funds in China.

## 5. Strengthening of the obligations of investors, controlling shareholders and related parties

Article 5, Article 6, Article 9 and Article 12 of the Draft stipulate the obligations of investors, controlling shareholders, actual controllers and related parties of private equity funds, including but not limited to disclosure obligation upon related party transactions, limitations on sales promotion, limitation on behaviors prohibited by related regulations and limitations on illegal activities. These articles, though not very detailed, are expected to significantly increase compliance obligations to the private equity fund industry.

## Conclusion

As the private equity industry in China grows and evolves, the regulatory agencies have become more diversified in their supervision methods and are aiming to increase supervision to fill some regulatory loopholes. We anticipate that the regulatory burden on private equity funds in China will only increase in the future, so it's best to get prepared and raise your compliance standards to industry best practices as soon as you can.

For more information, please see the following resources

- [China Updates page](#)
- [China Releases Provisions on the Unreliable Entity List](#), October 5, 2020
- [China Releases Revised Measures on Handling Complaints of Foreign-Invested Enterprises](#), September 23, 2020
- [China Releases Administrative Measures for Strategic Investment by Foreign Investors in Listed Companies](#), September 10, 2020
- [China Releases Draft Data Security Law](#), September 8, 2020
- [China Releases Circular on Further Stabilizing Foreign Trade and Foreign Investment](#), August 24, 2020
- [China Releases Draft Measures for the Administration of Imported and Exported Food Safety](#), August 18, 2020
- [U.S. Listed Chinese Companies: Regulatory Scrutiny and Strategic Options](#), July 30, 2020
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