

# Legal Commentary

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## New Private Funds Regulation - Higher Level and Higher Quality

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### Overview

On July 9, 2023, the State Council of the People's Republic of China<sup>1</sup> promulgated the *Regulations on Supervision and Administration of Private Investment Funds* ("**Regulations**"), which will take effect from September 1st, 2023. According to the Q&A regarding the Regulations published by the China Securities Regulatory Commission ("**CSRC**") and the Ministry of Justice ("**Q&A**"), the Regulations are primarily intended to ensure financial security through controlling risk sources and to enhance the functioning of private funds to support the real economy. In addition, the Regulations aim to define the bottom line of regulatory supervision, strengthen interim and ex post supervision, and adopt a differentiated regulatory approach for regulating various types of private funds, especially venture capital funds.

Prior to the promulgation of the Regulations, the *Interim Measures on Supervision and Administration of Private Investment Funds* issued by CSRC in 2014 (the "**Interim Measures**") used to be the overarching rule to set the foundation for regulating the private funds market. But the Interim Measures have become insufficient over the years given its lower legislative level (as departmental rules issued by the industry regulator, compared to the Regulations issued by the State Council) and the rapid developments of the industry in the past decade. This has made the Regulations necessary to refine the legislative system for private funds and promote the high-quality development of the industry.

### Highlights of the regulations

#### I. Differentiated treatments for different types of managers and funds

The Regulations provide the principle of differentiated treatment that CSRC will (i) conduct differentiated supervision and administration according to certain key factors such as business types, AUM, ongoing compliance status, risk control situations and (ii) adopt classified supervision and administration on various types of private funds, including private equity funds, venture capital funds and securities investment funds, etc.

<sup>1</sup> For the purpose of this newsletter, references to the PRC are exclusive of Hong Kong, Macau and Taiwan.

## **II. Enhanced supervision of relevant principals**

The Regulations enhance requirements on private fund managers, their shareholders, actual controllers, senior management personnel and employees by summarizing and prohibiting activities that damage the interests of investors and disrupt the financial order and emphasizing duties and registration/filing matters of private fund managers.

## **III. Stricter and clearer penalties**

Compared with currently effective rules, the Regulations provide stricter and clearer administrative measures for various non-compliance issues of private fund managers. The regulator intends to decrease the number of non-compliance cases by increasing the cost of violations by private fund managers.

## **IV. Implementing principles with flexibility**

The Regulations intend to strike a balance between sticking to bottom line principles and providing for appropriate flexibility. For example, while the Regulations confirm that private funds must comply with regulatory requirements on the limit of investment layers (e.g., the Super Guidance), there is an exception that certain recognized types of funds (including any master funds, venture capital funds and government funds, which primarily invest in other private funds) will not be counted into such investment layers.

## **V. Foreign-invested fund managers and cross-border fundraising**

The Regulations provide that the administrative measures for foreign-invested private fund managers will be separately formulated by CSRC and the relevant departments of the State Council in accordance with rules relating to foreign investment and the Regulations. This indicates that there may be new rules specifically applicable to foreign-invested private fund managers such as QDLP, QFLP and PFM WFOEs and JVs. We think it may be a positive development to have a separate rule taking into account such foreign-invested managers' unique features while at the same time providing a more unified regulation applicable to such managers.

The Regulations further provide that offshore institutions may not directly raise money from onshore investors to establish private funds and private fund managers must comply with the PRC rules to engage in business activities offshore. While there remains uncertainty on how to interpret the scope and definition of "direct onshore fundraising" by offshore institutions, our current general view is that this is consistent with the existing regulatory spirit applicable to onshore marketing/offering of offshore funds. From a literal reading, the legitimate practice of overseas asset managers establishing a WFOE or JV manager (such as QDLP or QFLP manager) to launch onshore funds should not be impacted by this provision.

Given the above provisions are very high-level, it is worth continuously monitoring the further developments and revisiting relevant risk analysis as necessary.

## Outlook

For market players, it is important to have a reasonable expectation on the upcoming regulatory efforts. According to the Q&A, CSRC will, in accordance with the Regulations, amend the Interim Measures with respect to matters of fundraising, investment operation, information disclosure and implement differentiated supervision per business types, AUM, ongoing compliance status, risk control circumstances and the ability to serve investors; CSRC will also lead Asset Management Association of China to refine self-discipline rules on registration and filing, fund contract guidance and regulatory reporting as appropriate.

It is anticipated that implementing rules will be further formulated to support the Regulations and the market will benefit from the higher-quality administrative supervision. We will monitor these developments and provide updates as they occur.

## ***Important Announcement***

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