

# A New Regulatory Development for PRC Private Investment Funds and Fund Managers

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NEWSLETTER

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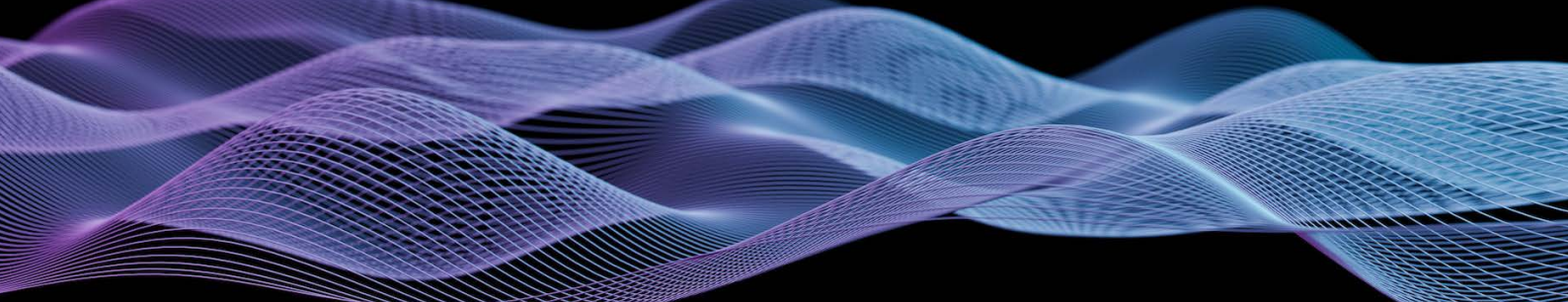
On 8 December 2023, the China Securities Regulatory Commission (CSRC) issued the *Consultation Draft of Measures on the Supervision and Administration of Private Investment Funds* (“**Draft Private Fund Measures**”) to implement the *Regulations on the Supervision and Administration of Private Investment Funds* (“**Private Fund Regulations**”). The Private Fund Regulations, which has been promulgated by the State Council on 9 July 2023, is the highest-level legislation issued to specifically regulate private investment funds and fund managers. The Draft Private Fund Measures are the second highest-level of PRC legislation and set out higher requirements on private investment funds and fund managers than those in the existing self-regulatory rules issued by the Asset Management Association of China (AMAC).

According to Article 79 of the Draft Private Fund Measures, once the measures are officially implemented, any newly established private investment fund or fund manager must follow the requirements set out in the Draft Private Fund Measures, which we will summarize below. However, existing private investment funds and fund managers will be granted varying grace periods to comply with the requirements under the measures, including (1) two years for compliance with the “multi-layer investment restriction”, and (2) one year for compliance with requirements other than the fund manager name and business scope requirements, the CNY 10 million minimum paid-in capital, and the minimum shareholding requirement for senior management in the fund manager. It remains unclear whether existing fund managers need to comply with the exemptions in (2) above or just would be given a longer grace period for compliance with these exemptions.

The following are some of the highlights of the Draft Private Fund Measures.

### • Fund manager requirements refined

Compared with the previous interim measures (*i.e. Interim Measures for the Supervision and Administration of Private Investment Funds*), which were introduced by the CSRC on 21 August 2014, the Draft Private Fund Measures set out more specific requirements on private fund managers in respect of their name, business scope,



shareholders, senior management and practitioners of, and the requirements on the prohibited activities of shareholders, actual controllers and partners of private fund managers.

Furthermore, the Draft Private Fund Measures intend to impose different regulatory requirements on private fund managers based on AUM thresholds to be specified later and on fund managers in under common control. Moreover, these measures will also regulate private fund manager's investment with its proprietary capital and will establish requirements on the private fund manager's establishment of subsidiaries and its other activities.

- **Differentiated supervision of private funds adopted**

The Draft Private Fund Measures adopt a “differentiated supervision” approach to supervise private funds (*i.e.* private equity investment funds, venture capital funds, single-LP funds and project funds) by setting different requirements on investment limits, minimum paid-in capital, and minimum LP commitment based on different fund types. The differentiated supervision relaxed the requirements for venture capital funds whilst impose higher standard on project funds and single-LP funds.

- **Negative list concept for private fund investment strengthened**

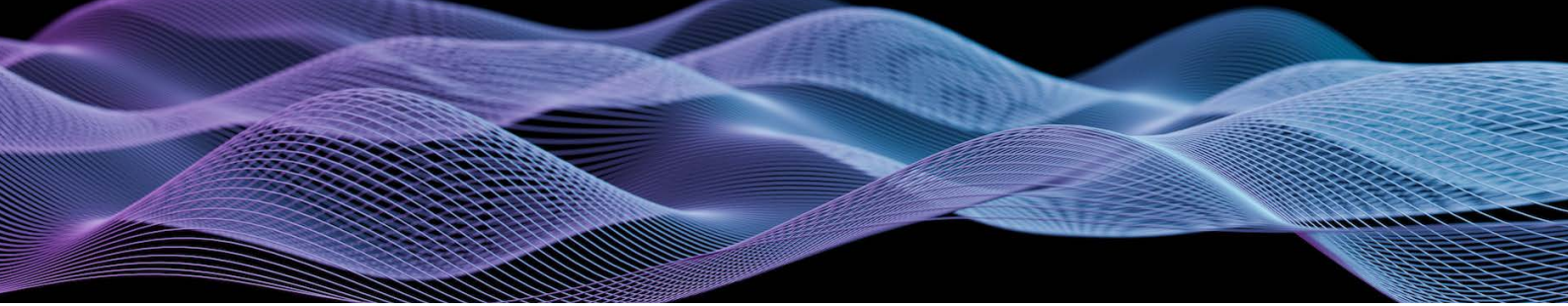
The Draft Private Fund Measures specify that private funds may not, directly or indirectly, invest in the following prohibited areas: (1) credit, loans (deposits), guarantees other than bridge investment no longer than 1 year; (2) assets that are invested in factoring, financial leasing, pawnbroking and other similar business that may conflict with private fund business (“**Conflicted Business**”), the rights to receive benefits from assets held by a Conflicted Business or the equity a company engaged in a Conflicted Businesses; (3) investments with unlimited liability; (4) investments in projects prohibited by the state or noncompliant with the state's industrial policies, environmental protection policies, land management policies, *etc.*, with the exception of investment in the securities market; (5) investments that increase the government “hidden debt” overtly or covertly; and (6) other areas prohibited by PRC laws and regulations or by the CSRC. This is the first time the concept of “negative list” is mentioned by CSRC.

- **Private fund custodian more specifically required**

According to the Draft Private Fund Measures, a custodian must be engaged for a private fund if it: (1) is a contractual fund; (2) accepts investment from asset management products or private funds; (3) mainly invests in a single project, overseas assets, over-the-counter derivatives, *etc.*; (4) engages in leveraged financing; or (5) is otherwise required by the CSRC. Names of those private funds that have failed to engage a custodian will be made public by AMAC. This new requirement represents an expansion in custodial requirements as current regulations only require contractual funds or funds investing through SPV to engage a custodian.

- **Qualified investors' criteria modified**

For investors who are individuals, under current PRC fund legislation, subject to certain limited exemptions, only those with personal financial assets of at least CNY 3 million or annual income of at least CNY 500,000 for the past three years will be deemed as “qualified investor”. The Draft Private Fund Measures, however,



determine the individual investor's assets on a "family" basis and differentiate "gross assets" and "net assets" taking into account the fact that Chinese individual investors are likely to hold mortgaged properties. Individuals with family financial gross assets of at least CNY 5 million, family financial net assets of at least CNY 3 million or personal annual income of at least CNY 400,000 for the past three years could be "qualified investors" according to the Draft Private Fund Measures.

Nevertheless, the Draft Private Fund Measures set higher paid-in capital requirements compared to current PRC fund legislation for any single investor's minimum investment in private funds: (1) CNY 3 million in an ordinary private equity fund; (2) CNY 5 million in (i) a real estate fund, (ii) a single project fund (for institutional investor's investment), a fund investing in overseas assets or over-the-counter derivatives, *etc.*, (iii) a fund that has not engaged a custodian, and (iv) a private equity fund sold by a private fund sales agency; and (3) CNY 10 million for any individual investor's investment in a single project fund.

- **Supervision of the fundraising process tightened**

The Draft Private Fund Measures tighten standards on fundraising from individual investors. During the fundraising process, the fund manager or fund sales agency must record or video the entire interactions with individual investors, and must establish and improve the mechanisms of revisiting investors for confirmation and verification and investment cooling-off period mechanisms.

In addition to the highlights described, the Draft Private Fund Measures also set out detail requirements on fund manager's ongoing compliance and information disclosure and on private fund's investment layers and classification. Both of which basically follow the existing regulatory regime for the private investment fund industry and introduce no real regulatory innovation.

In summary, the Draft Private Fund Measures signal that PRC authorities aim to provide a legislative boost to the private sector by further standardizing market practices by private investment funds and fund managers. We look forward to seeing how the Draft Private Fund Measures are implemented as well as how they and other regulations boost private sector.

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Note: If you have any questions or comments about the Draft Private Fund Measures, Fangda Partners team would be happy to discuss with you. We are in the process of preparing comments to the Draft Private Fund Measures for submission to the CSRC on 8 January 2024, and would be happy to incorporate your thoughts and comments in our response to the CSRC.