

Analysis of Public Offerings and Private Placements Under PRC's Legal Framework

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The methods used to issue securities are normally classified into one of two categories: Public offerings or private placements. They are clearly defined in the PRC Securities Law (Securities Law), which was revised in 2005. However, given that the scope and variety of securities are becoming increasingly broad, it would be of significance, in practice, to define public offerings and private placements in a broader context.

Basic Meanings of Public Offerings and Private Placements and Relevant Concepts

➤ Public Offerings and Private Placements

Public offerings and private placements are the two basic methods for issuing securities. However, the terms are not used in the Securities Law. Generally, public offerings refer to the issuance of securities to unspecified investors publicly, while private placements refer to the issuance of specific investors privately. However, except as defined under the Securities Law, even the concept of securities in the financial market remains unclear.

➤ Public Offerings and Non-public Offerings Under the Securities Law

Securities clearly regulated by the Securities Law are stocks and corporate bonds, while the issuance of State bonds and funds shall be governed by other laws and regulations. For the issuance of other securities derivatives, the Securities Law authorizes the State Council to enact relative provisions pursuant to the principles of the Securities Law. Accordingly, the issuance methods, regulated by the Securities Law, include public offering and non-public offering.

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The Securities Law stipulates that it shall be deemed to be a public offering if any of the following happens: Issuing securities to non-specific investors; issuing securities to targeted persons, who number more than 200 in aggregation; or other issuances regulated by laws and administrative regulations. The definition of public offering by the Securities Law is different from the definition under the Tentative Measures for the Administration of the Issuance and Trading of Stocks promulgated by the State Council in 1993. It can be concluded from the preceding provisions that non-public offerings in the Securities Law are for targeted investors who number no more than 200. Meanwhile, it is clearly stated in the Securities Law that any securities not issued in a public manner, “advertisement, public solicitation or public issuance in any disguised form are not allowed.”

There are basic definitions under the Securities Law for public offering and private placement of securities. However, it is silent on operational provisions of the non-public offering of securities. It only provides that for the non-public offering of new stocks, a listed company shall meet the requirements outlined by the securities regulatory body approved by the State Council, and that it shall report to the securities regulatory body for verification and permission. However, no framework regulations have ever been drafted by the Securities Law and CSRC (China Securities Regulatory Commission) with respect to non-public offering of stocks and corporate bonds by non-listed companies. Considering the particularity of listed companies (information disclosure), rules for non-public offering of stocks (introduction of strategic investors by private placement) by listed companies may not make much sense for the non-public offering of other securities.

➤ Offering to Specific Investors

The term “offering to specific investors” could be found in the Tentative Measures for the Administration of the Issuance and Trading of Stocks, which was formulated by the State Council in 1993. Article 11 of those measures sets out specific requirements for applying for public offering of shares by companies established by offering to specific investors.

Companies established by offering to specific investors refer to those joint-stock companies that only offer shares to legal persons and their employees — without offerings to public. The previous State Commission of Economic System Reform once promulgated an official document regarding offerings to internal employees, and it provides that holding of stocks by employees, by way of offering to specific investors, shall not be implemented until it is approved by the local reform authority. Holding of stocks by employees complies with some basic features of private placements (issuing to targeted investors in a non-public manner), as the method earliest regulated in private placement of securities is a special private placement under specific circumstances in the course of development of the economic system.

➤ Targeted Offering

Targeted offering is an issuance method opposite to public offering in the regulations and regulatory documents promulgated by the commissions and ministries of the State Council. For instance, the Tentative Measures for the Administration of Bonds of Securities Houses provides that bonds of the securities houses may, as approved, be issued to public or to specific qualified investors.

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Practice in Private Placements

There are no regulations with respect to private placements, but we can still find private placements, or concepts and practices similar to them; for example, the issuance of bonds by securities houses, the promotion and issuance of collective fund trust plans by trust companies, and financial bonds issued by banks.

➤ Targeted Offering of Bonds by Securities Houses

According to the Tentative Measures for the Administration of Bonds of Securities Houses, revised in 2004 by CSRC, securities houses may, as approved, issue bonds publicly to public or specific qualified investors. The Measures provide that targeted offering of bonds can only be made to qualified investors. The qualified investors refer, as defined in the Measures, to those lawfully established legal persons or investment institutions with the capability to make independent judgment on securities investments and take risks, and which can engage in investments of securities in accordance with relative regulations and their articles of association with an amount of registered capital that exceeds RMB 10 million, or audited net assets that value more than RMB 20 million.

➤ Collective Fund Trust

To a great extent, collective fund trust can also be deemed to be a fund-raising method that differs from public offerings, and which is in line with the basic characteristics of private placements.

According to the present Measures for the Administration of Collective Fund Trust Plans of Trust Companies, investors in a trust plan initiated by a trust company shall be qualified investors. The so-called qualified investors refer to those who are able to identify, judge and bear risks of trust plans, including any natural person, legal person or other lawfully established organization with a minimum fund amount of RMB 1 million, or any individual or family with an amount of financial assets that exceeds RMB 1 million at the time of subscription, or any person with an amount of annual income that exceeds RMB 200,000 in the last three years, or the aggregate annual income of the wife and husband exceeds RMB 300,000 in the last three years. For the number of investors, there is no limitation on the number of institutional investors, while the number of individual investors shall not be more than 50 (before said Measures, limitation on the number of investors, both including individual and institutional investors, could not exceed 200). Meanwhile, trust companies shall not make conduct marketing or entrust non-financial institutions to conduct marketing when trust plans are promoted by trust companies.

➤ Financial Bonds

Targeted offerings can also be used for issuance of financial bonds and commercial banks' subordinated bonds. However, these two bonds are not corporate bonds under the Securities Law. Financial bonds are securities issued at the national interbank bond market by China-based financial institutions, with payment of principal and interest as agreed. Commercial banks' subordinate bonds are bonds issued by commercial banks at the national interbank bond market, and the payment order of principal and interest is after other debts of commercial banks, but before equity capital of commercial banks.

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Let's take private placement of financial bonds as an example. According to the Measures for the Administration of Financial Bonds Issuance at the National Interbank Bond Market, financial bonds are issued on a targeted offering basis only to underwriters and sub-distributors. Underwriters refer to qualified financial institutions that comply with PBOC (People's Bank of China) requirements, while the sub-distributors refer to such institutional investors as Chinese-funded banks, Chinese-funded commercial insurance companies and rural credit cooperatives approved by PBOC. Insurance companies are among the main investors of commercial banks' subordinated debts.

➤ Private Fund

There is no clear legal definition for the term of private fund. Article 101 of the Fund Law provides that the specific administrative measures for fund-management companies, and other institutions approved by the State Council to engage in securities investment activities with funds raised from targeted investors, or to accept property trust from targeted investors, shall be separately provided by the State Council pursuant to the Fund Law. To the best of our knowledge, the State Council has not formulated relevant administrations for the operation of private funds. Generally, a trust company will work with a specialist, private fund-management company to raise private funds through the issuance of fund trust plans.

Conclusions

On the basis of the aforesaid analysis, we can review public offerings and private placements from the following perspectives:

➤ Regulatory Bodies

Almost all of the products that are publicly offered are under CSRC's supervision. However, private placements are regulated by different regulatory bodies (mainly CSRC, CBRC and PBOC), based on financial institutions and financial products involved, which lead to difficulties in the formation of uniform regulations on private placements. Therefore, it is worth discussing the necessity and possibility to form a unified set of regulations on private placements.

➤ Definition of Qualified Investors

Compared with the general public in public offerings, private placements face relatively sophisticated investors. However, in terms of the different risks for different products, it is difficult to stipulate requirements for qualified investors, or such requirements must be adjusted, subject to changes in the market, as far as the requirements for qualified investors are concerned.

➤ Limitations on the Number of Investors

We can infer from the analysis that limitations on the number of investors are not an indispensable prerequisite requirement for various private placements. However, the Securities Law clearly specifies the limitation of 200 investors, and the limitation of 200 investors in the previous trust plans has been changed to a maximum of 50 individual investors. To some extent, the size and effect of private placements are limited by them, and some institutions have tried to avoid such limitations through different methods.

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➤ Methods of Promotion

Another main aspect in which private placements differ from public offerings is whether it is allowed to make public promotional activities. However, it is uncertain how to define the promotional activities that can be made in private placements in economic activities with a boom of various marketing (including marketing via new media on the Internet); for instance, whether advertising is allowed.

➤ Requirements for Information Disclosure

The requirements for information disclosure on publicly offered products are clear and strict. However, it is necessary for laws and regulations to formulate basic guidelines for the regulatory requirements for information disclosure on privately placed products, and on consultations among the investors subject to different situations.

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