A New Era of the Private Fund Sector:

Highlights of the Private Fund Regulation

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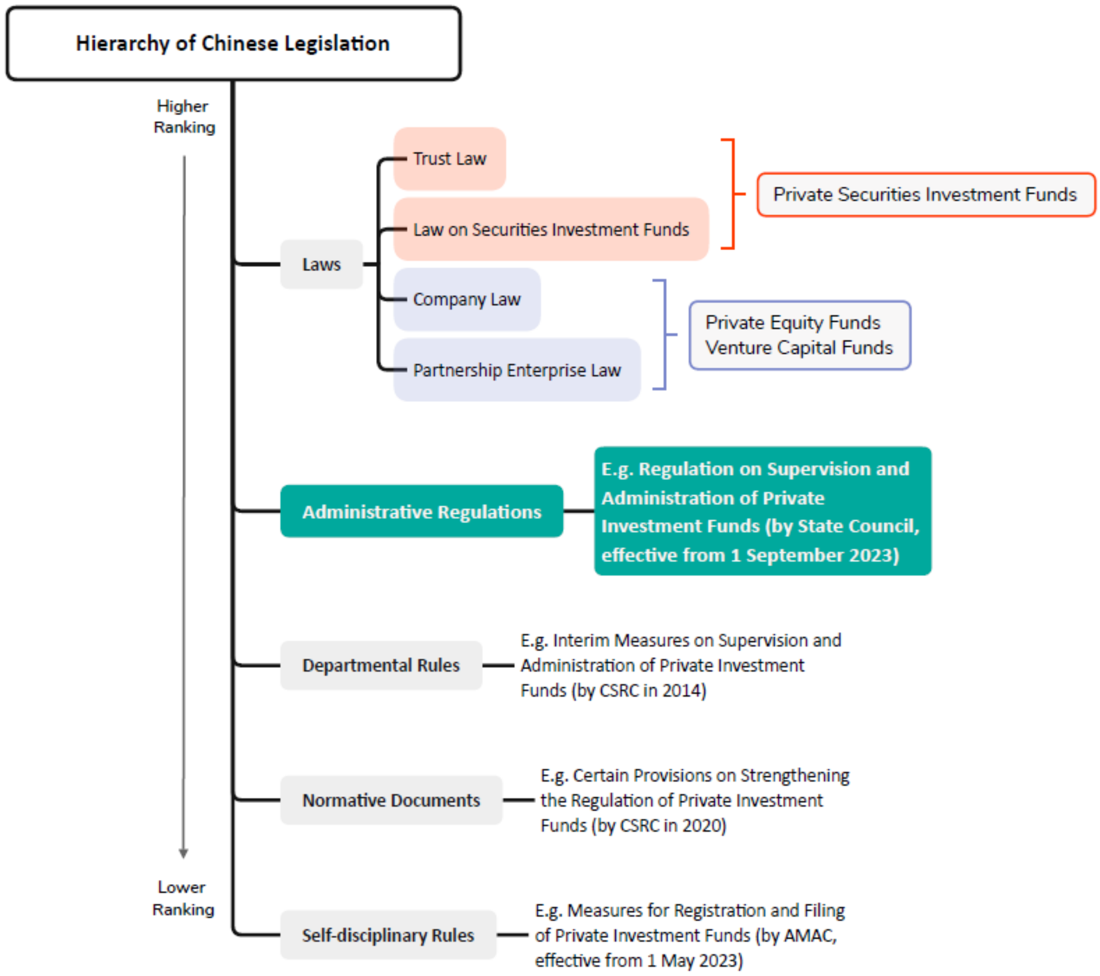
In 2013, the China Securities Regulatory Commission ("**CSRC**") submitted the proposal to the State Council on formulating an administrative regulation governing private funds. In 2017, the *Provisional Regulation on Administration of Private Investment Funds (Consultation Paper)* was published for public comment. On 9 July 2023, the State Council unveiled the *Regulation on the Supervision and Administration of Private Investment Funds* ("**Private Fund Regulation**"), which will come into effect as of 1 September 2023. It took ten years for the Private Fund Regulation to arrive. The CSRC will revisit and refine the existing departmental rules, normative documents and self-disciplinary rules in the next step. The specific actions may include, among others, amending the *Interim Measures on Supervision and Administration of Private Investment Funds* ("**Private Fund Measures**") pursuant to the Private Fund Regulation to specify relevant requirements, guiding the Asset Management Association of China ("**AMAC**") to improve its self-disciplinary rules on registration, filing, fund contract drafting, information reporting, etc. in accordance with the Private Fund Regulation and other regulatory rules of the CSRC.

According to the *Legislation Law of the People's Republic of China*, the Private Fund Regulation is an administrative regulation promulgated by the State Council. The legal hierarchy of the Private Fund Regulation is lower than that of laws, but higher than that of departmental rules, local regulations, normative documents and self-disciplinary rules. The promulgation of the Private Fund Regulation contributes to the building of a more complete top-down legislation system (as below) that governs private funds.



According to the judicial interpretations of the Supreme People's Court of the People's Republic of China, the Private Fund Regulation is one of the legislations that the people's courts are able to directly cite for their judgements in civil and administrative litigations relating to private funds, which is quite meaningful for the dispute resolution in the private fund sector. After all, the rules and regulations whose legal hierarchy falls under that of the Private Fund Regulation are not within the statutory scope of legislations that the PRC competent courts can directly cite in their judgements.

The promulgation of the Private Fund Regulation is a milestone for the private fund industry. The development, practice and expectation of the industry have been duly embodied in the major principles and requirements contemplated under the Private Fund Regulation, which also comprehensively enhances the risk control, draws the regulatory bottom-line and promotes the compliant operation of private funds. The Private Fund Regulation consists of seven chapters, covering basic principles, private fund manager and private fund custodian, fundraising and investment operation, special provisions for venture capital funds, supervision and administration, and legal liability. This article aims to summarize the highlights of the Private Fund Regulation and provide brief analyses.

I. Scope of Application

Where, within the PRC, raising funds in a private manner to launch investment funds (in a contractual form) or to incorporate companies or partnerships purported to conduct investment activities, under the management of the private fund managers or general partners to make investments for the interest of the investors, the Private Fund Regulation shall apply. In China, private products, broadly defined, also include private asset management products launched by financial institutions (such as private asset management schemes launched by the CSRC-regulated asset managers, private wealth management products launched by bank wealth management subsidiaries, trust schemes, insurance asset management products). However, in combination with the requirements on registration of private fund managers and general partners (in the case that the assets of a partnership-type fund are managed by the general partner) as stipulated by Article 7 and Article 10 of the Private Fund Regulation, we hold the view that, under the current registration and filing regime, among the different types of private products and the managers thereof, the Private Fund Regulation governs (1) private fund managers registered with AMAC, and (2) private funds launched and managed by such private fund managers and filed with AMAC (private securities investment funds, private equity funds, venture capital funds).

II. Private Funds

1. Independence and Segregation of Fund Assets of Private Funds

Article 4 of the Private Fund Regulation clearly provides that "fund assets of private funds shall be independent from the proprietary assets of private fund managers and private fund custodians". Paragraph 2 of Article 16 of the Private Fund Regulation provides that "the private fund custodian shall establish a mechanism for segregation of its custody business and other business according to law, so as to ensure the independence and safety of the fund assets”. Article 30 of the Private Fund Regulation regarding the prohibited acts of private fund managers, private fund custodians and their employees also explicitly forbids commingling their proprietary assets or others’ assets with the fund assets of private funds. This is consistent with the provision of the Law on Securities Investment Funds which states that fund assets shall be independent from the proprietary assets of the fund manager and the fund custodian, and the fund manager and the fund custodian shall not comingle the fund assets into their proprietary assets. As the independence of the fund assets of private securities investment funds has long been supported by the Law on Securities Investment Funds as a higher-level law, the Private Fund Regulation provides a solid legal basis for the independence and segregation of the fund assets of private equity funds at the level of administrative regulations, especially those of private equity funds in the contractual form, which is of far-reaching significance.

2. Fundraising of Private Funds

Compared with the *Provisional Regulations on Administration of Private Investment Funds (Consultation Paper)* in 2017 which provides in a positive way that a private fund manager may engage eligible fund distributors to raise funds, the Private Fund Regulation stipulates that “a private fund manager shall raise funds on its own, and shall not engage others to raise funds on its behalf, unless otherwise provided by the CSRC”.

Currently, according to the Measures for the Supervision and Administration of Fund Distributors of Retail Securities Investment Funds and its implementation rules, the engagement of fund distributors for private securities investment funds is still lawfully recognized, but the independent fund distributors (note: a type of fund distributors similar to the IFA) are no longer allowed to sell private equity funds. Based on the *FAQ of Ministry of Justice and the CSRC on the Private Fund Regulation* and the CSRC’s 2023 Annual Legislation Plan, the CSRC will amend the Private Fund Measures in accordance with the Private Fund Regulation, and will also guide AMAC to improve its self-disciplinary rules. It is foreseeable that various issues may be clarified in the revised Private Fund Measures (such as whether it is permitted to engage fund distributors for the fundraising of private funds, and if yes, the types and requisite conditions of private funds that can be distributed, and types and requisite conditions of fund distributors that can be engaged), and AMAC’s self-disciplinary rules such as the *Administrative Measures for Fundraising Activities of Private Investment Funds* may also need to be revised accordingly.

3. Registration of Rights of Contractual Private Equity Funds in Investment Targets

Since contractual private equity funds cannot be registered with the company registry as the shareholder or partner of the investment targets, in practice usually it is the private fund managers that are registered as the shareholder or partner, which leads to legal risks relating to the independence of fund assets and shareholding entrustment. In 2022, Shenzhen took the lead in launching a pilot program for business registration of contractual private funds which hold equity interests or partnership interests. This pilot program allows contractual private funds to be registered as shareholders of investee companies or partners of partnerships in the form of "private fund manager name (representing 'name of contractual private fund')". Article 21 of the Private Fund Regulation also clarifies that when opening accounts in the name of a private fund manager, being listed in the shareholders' register of an investee company with the name of the private fund manager or holding units in other private funds in the name of the private fund manager, the name of the private fund shall be specified. This provision will facilitate the business registration of contractual private equity funds.

4. Filing of Private Funds

The requirements on the filing materials of a private fund under Article 22 of the Private Fund Regulation are basically consistent with those under the Measures for Registration and Filing of Private Investment Funds ("**Registration and Filing Measures**") taking effect on 1 May 2023, which also require investors to submit the relevant information of investors' ultimate beneficial owners. The reporting standards for ultimate beneficial owners of investors and the scope of information have yet to be clarified in AMAC's Asset Management Business Electronic Registration System ("**AMBERS**"). With the future upgrades to AMBERS, such standards are expected to be clarified.

Meanwhile, we also notice that the Private Fund Regulation requires custody agreements or institutional measures for safeguarding the fund assets of private funds to be submitted as one of the filing materials. Currently, the documents checklist for filing of private investment funds issued by the AMAC only requires that custody agreements shall be submitted for private funds in the form of partnership or corporation, while the custody arrangement of contractual funds may be agreed in the fund contracts (i.e. there is no need to prepare separate custody agreements), which is a common practice in the private fund industry. It remains to be seen whether the promulgation of the Private Fund Regulation will have impact on the current model of custody-related legal documents.

5. Fundraising Size

According to Article 22 of the Private Fund Regulation, a private fund shall have the paid-in capital raised to ensure basic investment capacity and risk resistance ability. Article 33 of the Registration and Filing Measures sets forth requirements on the initial fundraising amount for a private fund, i.e. unless otherwise provided, the initial fundraising amount for private securities investment funds shall not be less than RMB10 million, the initial fundraising amount for private equity funds shall not be less than RMB10 million (venture capital funds are subject to other requirements), and the initial fundraising amount for private funds investing in a single target shall not be less than RMB20 million. From the above, the initial fundraising amount for private securities investment funds shall reach RMB10 million before its successful filing with AMAC. As for a private fund investing in a single target, AMAC has clarified that a single target shall be identified on a look-through basis, and if a master fund carries out portfolio investment, it will not be identified as a single investment target.

6. Reporting to CSRC and Private Fund Monitoring Mechanism

Article 94 of the Law on Securities Investment Funds provides that where the total amount of funds raised reaches the prescribed threshold, or the number of unitholders of a fund reaches the prescribed threshold, the fund industry associations shall report to the securities regulatory authority of the State Council. The Private Fund Regulation accordingly provides that AMAC will report to CSRC when the size of private funds has reached a specific fundraising scale or the number of investors has reached a specific threshold. Meanwhile, CSRC will develop a sound private fund monitoring mechanism to conduct centralized monitoring of private funds and holding of units by their investors.

7. Investment Layers

Article 25 of the Private Fund Regulation provides that "the investment layers of a private fund shall comply with the provisions of the financial administrative department of the State Council. However, a private fund whose dominant part of assets invest in other private funds shall not be considered to be an investment layer if it satisfies the requirements of the securities regulatory authority of the State Council". The *Guiding Opinions on Regulating the Asset Management Business of Financial Institutions* ("**Guiding Opinions**") issued in 2018 provides that an asset management product may further invest in another asset management product, but the latter may not further invest in an asset management product other than a retail securities investment fund. There have been different interpretations on whether private investment funds shall be subject to the multilayered nesting restrictions set forth in the Guiding Opinions. Through the Private Fund Regulation, it is confirmed that private funds generally shall be subject to the multilayered nesting restrictions set forth in the Guiding Opinions; meanwhile, the Private Fund Regulation also takes into consideration the practices in the private fund industry and grants exemptions under special circumstances, i.e. a private fund whose dominant part of assets are invested in other private funds can be excluded from the calculation of investment layers.

8. Investment Advisors

Article 27 of the Private Fund Regulation permits private fund managers to appoint other entities to provide investment advisory service for securities investment of private funds, the entities that accept the appointment shall be the investment advisors stipulated in the Law on Securities Investment Funds. We understand that this Article corresponds to Article 101 of the Law on Securities Investment Funds (stating that the fund manager may appoint a fund service provider to handle…investment advisory and other matters of the fund, provided that the liability to be assumed by the fund manager…shall not be exempted due to such appointment"). It is worth noting that the term "investment advisors" under the Private Fund Regulation refers to the service providers providing investment advice on securities and futures investment for private securities investment funds, rather than the sell-side advisors providing advices to clients on investing in securities investment funds (e.g. the robo-advisors). The Law on Securities Investment Funds does not provide for the qualification or procedure requirements for investment advisors of private securities investment funds. In 2016, CSRC promulgated the *Interim Regulation on Administration of Operation of Private Asset Management Business of Securities and Futures Business Institutions*, which defines the scope of investment advisors for private securities investment funds as "securities and futures business institutions legally permitted to engage in asset management business" and private securities investment fund managers that meet the "1 + 3 + 3" requirements. Meanwhile, AMAC implemented the filing requirements for investment advisors of private securities investment funds. It remains to be seen whether CSRC will set further qualification and procedure requirements for investment advisors of private funds by revising the Private Fund Measures in the future.

9. Related-Party Transactions

The Private Fund Regulation defines related-party transactions as transactions between the private fund and the private fund manager, the fund investors, other private funds managed by the private fund manager or other private fund managers under the same control of the actual controller, or other entities having major interested relationship with the foresaid entities. Compared with the provisions on material related-party transactions of retail funds under the Law on Securities Investment Funds, the scope of related-party transactions of private funds does not cover the fund custodian and other entities having major interested relationship with the fund custodian. Given that the higher-level laws governing private securities investment funds include the Law on Securities Investment Funds, and the fund custodian of a private securities investment fund bears the "trustee" role, we still suggest that the related parties of private securities investment funds be determined in a strict manner.

10. Audit Requirements

Article 29 of the Private Fund Regulation requires that a private fund manager shall engage an accounting firm to audit the assets of private funds <u>in accordance with the relevant provisions</u>. The provisions on the audit of private funds stipulated in the Registration and Filing Measures and the not-yet-officially promulgated *Guidance on Operation of Private Securities Investment Funds (Consultation Paper)* are as follows:

	Is Audit Required?	**Filing Requirements for Accounting Firms**
Private Securities Investment Funds	According to the *Guidance on Operation of Private Securities Investment Funds (Consultation Paper)*, a private securities investment fund whose net assets at the end of the year are more than RMB100 million shall, within	According to the Registration and Filing Measures, the annual financial report of a private fund whose AUM exceeds a certain amount and number of investors exceeds a certain number shall be audited by an accounting firm filed with the CSRC.

	four months after the end of each accounting year, submit its financial report audited by a qualified accounting firm.	According to the *Guidance on Operation of Private Securities Investment Funds (Consultation Paper)*, the annual financial report of a private securities investment fund whose net assets at the end of the year are more than RMB1 billion shall be audited by an accounting firm filed with the CSRC.
Private Equity Funds	The Registration and Filing Measures requires that a private equity fund shall, within six months from the end of each accounting year, submit its annual financial report audited by a qualified accounting firm.	According to the Registration and Filing Measures, the annual financial report of a private fund whose AUM exceeds a certain amount and number of investors exceeds a certain number shall be audited by an accounting firm filed with the CSRC.

In light of the above, currently AMAC only has mandatory audit requirements on private equity funds, while audit requirements on private securities investment funds are only mentioned in the *Guidance on Operation of Private Securities Investment Funds (Consultation Paper)*, and such mentioned audit requirements only apply to private securities investment funds whose net assets reach a certain amount. The Private Fund Regulation seems to uniformly require private fund managers to conduct audits of private funds without making a distinction, and does not expressly authorize CSRC to make other provisions. It remains to be seen whether "in accordance with the relevant provisions" here includes the Private Fund Measures to be amended by the CSRC, and whether audits of private securities investment funds will still be differentiated.

11. Operation Maintenance Mechanism and Market-oriented Exit Mechanism

Article 34 of the Private Fund Regulation provides a higher-level legal basis for the operation maintenance mechanism and market-oriented exit mechanism stipulated in the Registration and Filing Measures. In accordance with the abovementioned provisions, where a private fund manager objectively loses the ability to continue to manage the private fund, and cannot fulfill its obligations as a fund manager in fact, the replacement of the private fund manager shall be initiated in accordance with the fund contract; where the private fund manager is unable or slack to perform its obligations as a result of loss of contact, cancellation of private fund manager registration or occurrence of material risks, leading to the failure of the fund to exit normally (including the circumstance that no new private fund manager takes over the fund management duties in the above circumstance), it is required to establish a special institution or engage an accounting firm, law firm or other intermediaries in accordance with the fund contract, and properly dispose of fund assets, and accordingly the private fund shall enter the liquidation procedure.

III. Private Fund Managers

1. Differentiated Regulation

According to Article 6 of the Private Fund Regulation, CSRC shall implement differentiated regulation against private fund managers based on their types of business, AUM, ongoing compliance status, risk control conditions and abilities to serve investors, and shall implement classified regulation against different types of private funds such as private equity funds, venture capital funds, private securities investment funds. The Registration and Filing Measures also empowers AMAC to implement differentiated self-disciplinary management against different private fund managers and private funds.

The differentiated regulation could trace back as far as the Private Fund Measures released by the CSRC in 2014, which specifies that differentiated regulation shall be implemented against different private fund managers based on their credit records. The Private Fund Measures also establishes the institutional arrangement for differentiated regulation over different types of private funds. This regulatory philosophy has been reflected in a series of self-disciplinary rules issued by the AMAC thereafter. For instance, the AMAC imposes differentiated filing requirements in terms of different types of private funds. The Registration and Filing Measures does not mandatorily require the holding of equity in a private fund manager by its legal representative and the senior management personnel in charge of investment if it is controlled by any institution regulated by an offshore financial regulator. The Registration and Filing Measures also enhances the filing requirements of private funds engaging in innovative business on the basis of the differentiated regulation rule. The Private Fund Regulation, from the top-level design, further specifies that the private fund managers' types of business, AUM, ongoing compliance status, risk control conditions and abilities to serve investors will be taken into consideration by the CSRC when implementing differentiated regulation.

2. Duties of Private Fund Managers

The duties of private fund managers stipulated in Article 11 of the Private Fund Regulation correspond to the requirements under the Law on Securities Investment Funds. The diversity of private fund managers and private funds is also taken into account so the accounting and valuation duties of fund managers as stipulated in the Law on Securities Investment Funds are not cited. Another highlight of the Private Fund Regulation is the provision that "for an investment fund established by fundraising in a non-public manner, the private fund manager shall, in its own name, exercise litigation rights or take other legal actions for interests of the fund assets". That is to say, the Private Fund Regulation takes note of the subject issue of the litigation when contractual private funds with no legal personality are involved in litigation, which is also aligned with the provisions of the Law on Securities Investment Funds.

3. Management on Declaration of Personal Dealing by Practitioners

Article 26 of the Private Fund Regulation requires a private fund manager to formulate relevant policies for management on personal dealing declaration, registration, examination and disposal by practitioners, so as to prevent transfer of improper benefits and conflict of interest. It does not distinguish the types of private fund managers, nor does it distinguish the types of personal dealing subject to declaration. It should be reasonably explained that (1) all of private securities investment fund managers, private equity/venture capital fund managers shall formulate such policies, (2) all of their practitioners shall conduct declaration for personal dealing, and the scope of declaration should have a greater correlation with the types of the private fund managers and the types of private funds under their management. The control over personal dealing by practitioners exists for a long time in the retail fund sector and the private securities fund sector, and it is also quite essential for the internal control of global asset managers. The clear provision relating to personal dealing in the Private Fund Regulation is conducive to promote the healthy development of the private fund industry.

4. "Front Running" of Private Fund Managers and Their Practitioners

Article 30 of the Private Fund Regulation expressly provides that a private fund manager and its practitioners shall not use non-public information to engage in securities and futures transactions. The legal consequences of front running stipulated by Article 55 of the Private Fund Regulation are consistent with those stipulated by Article 123 of the Law on Securities Investment Funds.

In private fund sector, there have been front running cases, which were imposed with administrative punishment by taking Article 123 of the Law on Securities Investment Funds as the legal basis. However, such legal basis is somewhat not straightforward. Article 20 of the Law on Securities Investment Funds provides that "retail fund managers and their directors, supervisors, senior management personnel and other practitioners shall not … disclose non-public information obtained by taking advantage of their positions, engage in or expressly or implicitly instruct others to engage in, relevant trading activities by taking advantage of such information." Article 123 of the Law on Securities Investment Funds provides that "if a fund manager, fund custodian or their directors, supervisors, senior management personnel and other practitioners commit any of the acts listed in Article 20 of the Law on Securities Investment Funds, …". With the promulgation of the Private Fund Regulation, the legal basis for administrative punishment against front running in private fund sector has become clearer.

5. Requirements on Registration of Private Fund Managers under the Private Fund Regulation and the Registration and Filing Measures

Similar to the requirement of "compliance on a continuous basis" repeatedly emphasized in the Registration and Filing Measures, the Private Fund Regulation also stipulates certain requirements that a private fund manager shall comply with on a continuous basis, including good financial standing, holding of its equity by the legal representative and senior management personnel in charge of investment (unless otherwise stipulated by the State). It is worth noting that the Private Fund Regulation will take effect on 1 September 2023 without any grandfather clause or grace period. However, there is such a grandfather clause under the Registration and Filing Measures for private fund managers that have already registered with AMAC before 1 May 2023. For instance, the legal representative and senior management personnel in charge of investment of a private fund manager are not mandatorily required to hold the equity of the private fund manager if it completes registration with AMAC before 1 May 2023. As to foreign-invested private fund managers, the Registration and Filing Measures, at the level of self-disciplinary rules, has already made it clear that the mandatory equity holding requirement is not applicable to the private fund manager controlled by any institution regulated by an offshore financial regulator. How the Private Fund Regulation and the Registration and Filing Measures will link up and match with each other in respect of such requirement of "compliance on a continuous basis" is worthy of attention.

The provisions on the qualifications of shareholders, actual controllers, directors, supervisors and senior management personnel of private fund managers under Article 8 and Article 9 of the Private Fund Regulation are generally consistent with the Registration and Filing Measures. In addition, the events triggering deregistration of private fund managers under Article 14 of the Private Fund Regulation are also generally consistent with Article 76 and Article 77 of the Registration and Filing Measures.

The materials required for the registration of private fund managers under Article 10 of the Private Fund Regulation are generally consistent with the Registration and Filing Measures, which also include relevant information of the ultimate beneficial owners of shareholders, actual controllers and partners (as the case may be). AMBERS has been upgraded since the Registration and Filing Measures became effective, and the submission of ultimate beneficial owners of shareholder, actual controllers and partners (as the case may be) is also required under the updated documents checklist for registration of private fund managers released by the AMAC. However, how to identify the ultimate beneficial owners and which information shall be submitted have yet to be clarified in the documents checklist for registration of private fund managers and AMBERS. In the recent projects, the reporting of ultimate beneficial owners usually follows the requirements relating to ultimate beneficial owners under the anti-money laundering rules. We also notice the additional requirement of reporting the basic information of directors and supervisors under the Private Fund Regulation for registration of private fund managers. Though the Registration and Filing Measures has covered the disqualification scenarios applicable to directors and supervisors of private fund managers, no specific section could be found in AMBERS for reporting their information. With the promulgation of the Private Fund Regulation, AMBERS might need to be further upgraded to introduce the function for reporting information of directors and supervisors.

IV. Private Fund Custodians

It is explicitly provided in the Private Fund Regulation that "unless otherwise agreed in the fund contract, the assets of a private fund shall be under the custody of a fund custodian. If the fund assets are not under the custody, the policies, measures and dispute resolution mechanisms for ensuring the safety of fund assets shall be in place". It also provides that "if the assets of a private fund are under custody, the private fund custodian shall perform its duties according to law. The private fund custodian shall establish a mechanism for segregation of its custody business and other business according to law, so as to ensure the independence and safety of the fund assets". It could be seen from the foregoing provisions that, the assets custody requirement is not mandatorily required for private investment funds of non-securities type, which is in line with the current market practice. Meanwhile, the Private Fund Regulation does not cite the duties of private fund managers as stipulated in Article 36 of the Law on Securities Investment Funds, nor does it list out the specific duties of private fund custodians. Instead, a general language of "performing duties according to law" is used in the Private Fund Regulation, which, to some extent, leaves room for the financial regulators to make subsequent legislations in terms of the duties of private fund custodians, the scope of custody services and the division of relevant responsibilities.

For the avoidance of ambiguity, the higher-level legislations governing private securities investment funds include the Trust Law and the Law on Securities Investment Funds, according to which, the assets custody is mandatorily required for private securities investment funds. A private securities investment fund is subject to the "dual-trustee" structure, under which its fund manager and fund custodian are both "trustees". As a trustee, the custodian of a private securities investment fund shall fully perform its assets custody duties pursuant to Article 36 of the Law on Securities Investment Funds, and follow the principles set out in Article 145 of the Law on Securities Investment Funds to assume corresponding legal liability (i.e., in case of any damages to the fund assets or the fund unitholders due to any breach of the Law on Securities Investment Funds or the fund contract by the fund manager and/or the fund custodian in the course of performing their respective duties, they shall each assume the liability for compensation for their respective acts, and shall bear joint and several liability for compensation for their joint acts).

The private equity funds are not governed by the Law on Securities Investment Funds directly. Even if a private equity fund has a fund custodian, the fund custodian is not considered as a "trustee" under the Trust Law. The above principles for liability assumption by the fund custodian of a securities investment fund is not definitely applicable to the fund custodian of a private equity fund.

While the Private Fund Regulation does not provide clear provision on the custody duties of fund custodians of private equity funds, Paragraph 3 of Article 3 of the Private Fund Regulation basically cites the practicing obligations of the fund managers, fund custodians and fund service providers under Article 9 of the Law on Securities Investment Funds (i.e. "the private fund managers, private fund custodians, private fund service providers shall abide by laws and administrative regulations, <u>be dedicated to their duties, act in good faith and exercise due care and diligence</u> when (as applicable) managing and utilizing fund assets, safekeeping fund assets, and providing services to private funds). In other words, the Private

Fund Regulation has clearly imposed the fiduciary duties of private fund custodians at the level of administrative regulation, namely, the practicing obligations under Article 9 of the Law on Securities Investment Funds are extended from the area of private securities investment funds to the area of private equity funds.

V. Regulation by the CSRC

Chapter V of the Private Fund Regulation clarifies CSRC's role of regulating private fund business activities, and specifies the duties of CSRC, including (1) the duty to formulate regulations and rules relating to supervision and administration of private fund business activities, (2) the duty to regulate private fund business activities carried out by the private fund managers, private fund custodians and other service providers engaging in private fund business, (3) the duty to investigate and punish illegal acts, and (4) the duty to guide, inspect and supervise AMAC's functions of registration, filing and self-disciplinary management. CSRC may take measures such as onsite inspection, investigation and evidence collection, as well as inspecting and copying materials, records and account information when exercising the foregoing duties.

In addition, CSRC may take regulatory measures at different levels depending on the severity of legal or regulatory breach by a private fund manager, such as ordering it to make rectification, suspending its business, ordering it to replace relevant personnel, ordering it to transfer its equity or restricting its exercise of rights, performing mandatory audit, designating another institution to take it over, and notifying AMAC to cancel its registration.

VI. Legal Liability

Chapter VI of the Private Fund Regulation provides the administrative penalties that the private fund managers, private fund custodians, private fund service providers and their practitioners may be subject to for their violations against the Private Fund Regulation. The possible penalties include being ordered to make rectification, being ordered to stop business operation, illegal gains being confiscated, being fined, being warned, receiving a notice of criticism, being banned from market entry. We list some circumstances easier to be overlooked:

Circumstances triggering administrative liability	Penalties
Intervening in the business operation of a private fund manager without following the statutory procedures such as resolutions of the shareholders' meeting or the board of directors	1. Order to make rectification, give a warning or circulate a notice of criticism, confiscate illegal gains with a fine of more than one but less than five times the illegal gains; if there is no illegal gain or the illegal gains are less than RMB1,000,000, a fine of more than RMB100,000 but less than RMB1,000,000 will be imposed

	2. Give a warning or circulate a notice of criticism to the directly responsible person-in-charge and any other person directly accountable, together with a fine of more than RMB30,000 but less than RMB300,000
Failure to meet the requirement of "compliance on continuous basis"	1. Order to make rectification; in case of refusal to make rectification, give a warning or circulate a notice of criticism with a fine of more than RMB100,000 but less than RMB1,000,000, and order the fund manager to stop private fund business activities and make a public announcement on the same 2. Give a warning or circulate a notice of criticism to the directly responsible person-in-charge and any other person directly accountable, together with a fine of more than RMB30,000 but less than RMB300,000
Failure to appoint senior management personnel with corresponding professional experience to take charge of investment management, risk control, compliance and other roles Failure to establish the management policies for personal dealing declaration, registration, examination and disposal by practitioners	1. Order to make rectification, give a warning or circulate a notice of criticism with a fine of more than RMB100,000 but less than RMB1,000,000 2. Give a warning or circulate a notice of criticism to the directly responsible person-in-charge and any other person directly accountable, together with a fine of more than RMB30,000 but less than RMB300,000
Disclosing non-public information obtained by taking advantage of their positions, or engaging in or explicitly or implicitly instructing others to engage in relevant securities or futures transactions by taking advantage of such information	1. Order to make rectification, give a warning or circulate a notice of criticism, confiscate illegal gains with a fine of more than one but less than five times the illegal gains; if there is no illegal gain or the illegal gains are less than RMB 1,000,000, a fine of more than RM100,000 but less than RMB1,000,000 will be imposed 2. Give a warning or circulate a notice of criticism to the directly responsible person-in-charge and any other person directly accountable, together with a fine of more than RMB 30,000 but less than RMB 300,000

Meanwhile, according to Article 60 of the Private Fund Regulation, in the event that a person should assume both civil liability and administrative liability, the property of the person must be used, in priority, to assume the civil liability for compensation.

VII. Application to Foreign-Invested Private Fund Managers

According to Paragraph 1 of Article 61 of the Private Fund Regulation, the administrative measures governing foreign-invested private fund managers domiciled in the PRC shall be jointly formulated by the CSRC and other relevant departments of the State Council in accordance with foreign investment related PRC laws and administrative regulations, as well as the Private Fund Regulation. This provision aims to empower CSRC to formulate more specific rules applicable to foreign-invested private fund managers, e.g. eligibility requirements, admission procedures. The said “administrative measures” to be formulated by the CSRC will still take the Private Fund Regulation as the legislation basis. Therefore, in addition to the provisions otherwise set out in the said “administrative measures”, foreign-invested private fund managers shall also comply with the Private Fund Regulation in a systematic and comprehensive way.

According to Paragraph 2 of Article 61 of the Private Fund Regulation, offshore institutions are prohibited from directly raising funds from onshore investors to establish any private fund, unless otherwise stipulated by the State. Offshore institutions should be particularly cautious when facing up onshore entities or individuals, and in any event should avoid “raising funds from onshore investors directly”.

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