

Discussing the Legal Standards of Qualified Investors in Chinese Private Equity Crowdfunding

Kailiang Ma

Graduate School of China University of Political Science and Law, No.25, Xitucheng Road, Haidian
District, Beijing, China
kailiang.ma@hotmail.com

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ABSTRACT: The social practice and legislation of private equity crowdfunding in China are gradually developing and improving, and the qualified investors system is an important part. However, there are currently no specific laws and regulations on this interpretation. So this paper intends to define the nature of “private” on the equity crowdfunding, and analyze the standards of qualified investors from three aspects: the financing stage that investors involve in, the scale of investment and the nature of investor. On the basis of that, the corresponding measures to improve will be put forward. With the development of Chinese legislation and practice in this field, qualified investors will be examined through more abundant perspectives.

I. Introduction

Internet banking in China under the current environment is developing in full swing. Equity crowdfunding as an important form of Internet banking, with widespread power of the Internet technology, has become a potential crowdfunding mode. But the risk is accompanied by the opportunity. Especially, investors in the market vary greatly, and the purpose of investment is also diverse, yet China’s current law does not make the special provisions. On private equity, the relevant legal system is being studied and developed. Therefore, to a certain extent, the study on the standard of qualified investors to private equity crowdfunding has its construction significance.

II. The Nature of “Private” on the Equity Crowdfunding in China

China Securities Industry Association (CSIA) announced “Private Equity Crowdfunding Financing Management Approach (Trial) (Draft)” (hereinafter referred to as “Draft”) in 2014, which shows the non-public offering of equity crowdfunding. But the People's Bank of China and other ten departments issued “Guidance on Promoting the Healthy Development of Internet Finance” (hereinafter referred to as “Guidance”) in 2015, which regulates that the crowdfunding should be issued in public ways and the amount should be very small. Since then, the China Securities Regulatory Commission (CSRC) recognized the interpretation of “Guidance” on equity crowdfunding, but also said that they were also studying the development of private equity crowdfunding. Thus, it may be known that Chinese equity crowdfunding contains two ways, namely public offering and non-public offering. At present, Chinese government set limits to the issue in the open and small-amount ways, mainly for two reasons: first, the open issue will be audited, and the financing amount is small, thus lowering the relative risk of financing; second, the legislation on private equity crowdfunding is still discussed and developed (Defeng Yang & Xueli

Zhang, 2016).

The reason why this article research equity crowdfunding in the private sector, mainly have the following considerations: first, the system of qualified investors is mainly for private offering. Although there will be some requirements for the public offering to investors, but they are not very strict, which is decided by the purpose and characteristics of public offering; second, according to the provisions that Chinese Securities Industry Association released, the current choice is taking into account the actual situation of small and medium-sized enterprises in China and the conflicts between the small and medium-sized enterprises with public issuance. Although CSRC approved the explanation of “Guidance” on equity crowdfunding, the views of CSIA is also relatively rational form long-term perspective.

III. Legal Standards for Qualified Investors of Private Equity Crowdfunding

Through the investigation of the domestic and international legislation, we can find out that the provisions of qualified investors are not yet mature in China, and they are different from the foreign legislations. Differences are mainly embodied in the following aspects: in the limit of the scale of investment, China's existing laws and regulations do not involve the proportion of investment, but only include the total amount of investment restrictions; in terms of certification of investment capacity, Chinese law requires investors to demonstrate the ability to invest through financial strength, which is needed to be further improved; as for certification of qualified investors, initiative certification of regulators is encouraged and implemented. This is the continuation of the standard which bases on financial strength to determine investors' investment ability. So, what are the specific criteria to measure the accredited investor of equity crowdfunding? We can know it from different angles.

A. The Perspective of Stage that Investors Involve in the Financing

For the initial stage of financing, we can refer to the above describing standards of qualified investors from the static angle; then if investors want to transfer their equities, what are the requirements for investors to take over? There are no similar expressions in “Draft” and other laws and regulations, but in the private equity crowdfunding, the total number of investors shall not be more than 200, so you can study the actual requests on transferring the equities of investors according to the related provisions on initiator transferring shares in a joint stock limited company and initiator transferring equity in a limited liability companies in Company Law of China. At the same time, there are some related regulations in foreign laws, and many European countries do not set restrictions for share transferring, such as France and Britain, while the United States sets more stringent restrictions, for example, “equity may not be resold within 1 year, and the resale objects are strictly limited between the issuer and crowdfunding investor.” In addition, many Asian countries are also actively promoting legislation, such as China, South Korea and Japan. Therefore, China's legislature should combine the provisions of the existing Company Law with the foreign legislative outcome on equity crowdfunding to improve the restrictions on the transferring of equity.

B. The Perspective of Investment Scale

The greater the scale of investment is, the higher the risk coefficient is. So, the legal regulation should be stricter. In terms of the current legislative situation, the exemption system for small

financing is controversial in China. JOBS Act allows the issuer to launch a new form of small equity financing to individual investors through an intermediary under Title III, to set up the right of registration immunity for equity crowdfunding (Nir Vulkan, Thomas Astebro & Manuel Fernandez Sierra, 2016). There is not the exemption system for small financing in China now. For equity crowdfunding, the current law takes the record registration to guard against the risks, which is conducive to the transaction security, but the one-size-fits-all policy is not conducive to the financing efficiency. Therefore, in the future reform, China should pay attention to the design of a reasonable system based on the scale of investment.

C. The Perspective of the Nature of Investors

We can understand the legal standards from the perspective of natural persons and legal persons (institutional investors). From the previous description, we have explained the investors need to have the basic abilities of risk identification and risk bearing. Generally speaking, if in the same scale of investment, institutional investors will have better ability to identify risks than natural-person investors, so for natural-person investor, the risk identification study should be also more specific, more meticulous and stricter; if the scale of investment is different, assuming that institutional investors invest more than the natural-person investors, rigorous due diligence will be necessary for both sides, and the standards will not be the same (Gompers, 1995; Cumming & Dai, 2010).

IV. Suggestions on Improving the System of Qualified Investors in Private Equity Crowdfunding in China

From the current legislative situation and the development trend of the future, China should have the following improvements in the equity crowdfunding:

A. In View of the Stages of Investor Intervention in Private Equity Crowdfunding Financing

We should regulate the restrictions on the assignee qualification in investors' equity transferring. Abroad have different attitudes toward this, and some countries have no limitation, while some countries only give some necessary limit. But in the current market environment, in order to prevent financial risks and protect the transaction security, China should make some responses toward this question. Although Britain's equity crowdfunding is given priority to private equity, but it has no limit to the equity transferring, and to ensure to reach the investment purposes, China can draw lessons from the United States and South Korea on this regulation, and make strict rules for the duration and objects of equity resale; at the same time, China's legislature also can draw lessons from the related provisions of Chinese Company Law on equity transferring of limited liability company and shares transferring of joint stock limited companies, for example, investors may not transfer their holding shares within one year since the financiers succeed in fundraising, while giving the issuers and investors the preemptive right. As for others except the original issuers and investors, the rational voting procedure will be needed to ensure the smooth progress of equity transferring. These improvements not only need theoretical research, but also need to be summarized in practice.

B. In Terms of Investment Scale for Private Equity Crowdfunding

China should regulate it by setting the limits of the proportion of investment and the total amount

of investment. This should be distinguished by combining the characteristics of natural-person investors and institutional investors. From the foregoing narrative, we can know that many countries in the world have made the limits to the investment scale, and some of the countries represented by America and Britain focus on regulating the proportion of investment while some of the countries represented by Australia and Canada focus on the investment quota restrictions. Surely, there are some differences for the actual situation of countries. However, in terms of China, considering the actual financial differences between natural-person investors with institutional investors, China's legislature should also stipulate the investment ratio, which not only can control risks more scientifically, but also can effectively encourage investment.

In addition, China should consider setting the exemption system of small investment, namely below a certain amount, instead of the investors declaring to the regulatory authorities, the parties of the investment and financing investigate their own risks, and the crowdfunding platform is responsible for auditing risks (Michael B. Dorff, 2014). In terms of financial regulation, China should gradually realize the transition from government regulation to industry autonomy.

C. The Perspective of the Nature of Private Equity Crowdfunding Investors

The laws should distinguish between natural-person investors and institutional investors as well as professional and non-professional investors. On investors' capacity, considerations should be broadened, not limited to financial strength (Karen E. Wilson & Marco Testoni, 2014). Financiers should take into consideration the investment professionalism and background knowledge. Also, lawmakers should set the gradient limit according to the scale of investment, the nature of investors and professionalism of investors.

In the aspects of investment capacity, the legislature can take two ways: regulators certification and investors' initiative applying for certification (Magdalena Cholakova & Bart Clarysse, 2015). For applying for certification, the law should refine the corresponding system design, for example, the presumption of fault liability can be taken to examine the responsibility of the investors. Because in real life, not all investors are rational, so there will be certain resistance if financiers wish all investors to initiatively apply for certification. However, through the design of the presumption of fault liability, investors can feel their own risks so that the initiative certification will be promoted to reduce the related responsibility in a certain extent.

V. Conclusion

The development of Chinese equity crowdfunding is in the ascendant. And in the actual operation, although the legislature now regulates that it should be issued in open and small-amount ways, in the near future, the relevant laws and regulations will be perfected on private equity crowdfunding. On the investors of private equity crowdfunding, there are currently no specific laws and regulations in China except the general introduction in the "Draft". Of course, China's equity crowdfunding develops relatively late. Although the overseas' related legislations are abundant, there is no achievements of legislation which can completely match the Chinese actual conditions, for example, private equity crowdfunding is the mainstream in British, but China also draws on the American mode of public issue in addition to the experiences of the UK. At the same time, from the perspective of social practice, China still sums up the practical results on the legislation of private equity crowdfunding. For the future legislation prospect to rely on large data, the practical achievements are far from enough.

Of course, as for the investors of private equity crowdfunding, we can define them from investment objectives, investment capacity as well as the rights and obligations of the investors, and refine the standards of qualified investors according to the scale of investment, investment stage and investors nature. With the continuous improvement of Chinese related data, the point of view examining qualified investors will continue to innovate and current perspective will gradually sift the true from the false and really achieve the actual legislation effects.

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