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Editor
Stephen L Ritchie

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Chapter 4

CHINA

James Yong Wang[1]

I OVERVIEW

As the world's second-largest economy with a 9 per cent average GDP growth rate over the past two decades and a rapidly growing domestic market for new products and services supported by its 1.3 billion population, it is no surprise that China[2] continues to be one of most popular investment destinations for private equity and venture capital firms from all over the world.[3]

The concept of venture capital (VC) investment was first introduced in China in the late 1980s, and the Chinese government began to officially encourage foreign VC firms to invest in China in 1995. From 1995, the Chinese PE market grew at a rapid pace in respect of both fundraising and investments, and the number of PE/VC firms skyrocketed.[4] During the dot-com boom era, foreign PE and VC firms focused heavily on the booming internet industry in China, as exemplified by investments in China's leading internet companies such as Sina, Sohu and Netease. In 2000, US$2.1 billion was raised by PE funds focused on China. Following the burst of dot-com bubble, the growth of PE fundraising and investments in China slowed down. From 2006 to 2008, the PE market in China experienced a growth rate of nearly 100 per cent per year, culminating in a record number of US$61.2 billion raised in 2008, up from US$14.2 billion in 2006. The growth momentum was stopped by the global financial crisis, resulting in a modest

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1 James Yong Wang is with Han Kun Law Offices. The author acknowledges the assistance of his colleague Wei (Abby) Mei in preparing this article.

2 For purposes of this article, China does not include Hong Kong, Macao and Taiwan.

3 For purposes of this article, the term 'private equity' or 'PE' encompasses 'venture capital' or 'VC' unless indicated or the context requires otherwise.

4 While there were only a handful of PE/VC firms in 1995, the number jumped to over 6,000 in 2012.

amount of US$13 billion raised in 2009. In recent years, PE fundraising and investment in China have come out of the aftermath of the financial crisis and resumed a reasonably high growth rate. In 2013, a total of 349 new funds raised US$34.5billion.

Prior to 2007, China's PE/VC market was dominated by offshore PE and VC funds organised in offshore jurisdictions (typically the Cayman Islands). During that period, most foreign PE/VC funds made their investments into offshore holding vehicles of Chinese companies (the restructuring of such Chinese companies to establish offshore holding vehicles for offshore financing and IPO is called the 'red-chip' model) and sought lucrative returns through the IPO of such companies on US or other foreign stock exchanges. The 'red-chip' model was dealt a significant blow with the release of Circular 10 by the Ministry of Commerce (MOFCOM) in 2006, which subjected red-chip restructuring to MOFCOM scrutiny and no approval has been granted to any case. While the overseas IPO exit route has not been completely cut off (thanks to creative counsel finding ways to get around Circular 10), the domestic capital market naturally became an increasingly important part of the exit strategy of PE funds, especially as the Chinese government launched the Small and Medium-Sized Enterprise Board in 2004, the Growth Enterprise Board in 2009 and the New Third Board in 2012 in an effort to create a more dynamic, multi-layered capital market. Another significant step taken by the Chinese government to stimulate the growth of domestic PE market is the revamping of the Partnership Enterprise Law in 2006 to create the new legal form of 'limited partnership' commonly used by PE/VC funds in the developed world. Following the amendment of such law, renminbi-denominated funds mushroomed. In recent years, renminbi funds have exceeded offshore China funds in terms of both the number of new funds formed and the total amount of capital raised. For example, in 2013, a total of 313 disclosed renminbi funds raised US$23.3 billion, compared to 26 disclosed US dollar funds raising US$11.2 billion. Due to China's strict foreign investment regulation and foreign exchange control and with the increased intensity of the competition for deals, offshore funds increasingly find themselves at a significant disadvantage when competing with renminbi funds for domestic deals. Many foreign PE/VC sponsors thus started to incorporate an renminbi fund strategy into their overall China strategy, as further described in Section II, *infra*. At the same time, a number of Chinese PE/VC sponsors with a successful track record managing renminbi funds started to form and manage offshore funds in order to more nimble when competing for offshore (red-chip) deals.

II LEGAL FRAMEWORK FOR FUNDRAISING

When a fund sponsor embarks on the task of forming a PE/VC fund in China, one of the first things it needs to determine is whether to form a PE or VC fund.[5] The distinction

5 Note that the label of PE or VC on a particular fund does not necessarily indicate its investment strategy. An early stage venture fund could very well be formed as a PE fund. However, in order to become eligible for preferential tax and other treatments as a VC fund or raise capital from pools of capital administered by NDRC or its local counterparts, a fund has to be formed as a VC fund and stays in compliance with relevant NDRC guidelines.

is not just a difference in terminology but carries significant ramifications because PE and VC funds were created by different enabling regulations and were to some extent also regulated differently. VC funds were created by and operate under regulations of the National Development and Reform Commission (NDRC),[6] historically the principal regulator for the VC industry, while PE funds were created by local (e.g., provincial and municipal) regulations (literally translated from Chinese as 'equity investment enterprise' or 'EIE', as opposed to 'venture capital enterprise' or VCE). PE and VC funds differ in many respects, including required minimum fund size,[7] minimum investor subscription amount, record-filing requirement, capitalisation for its management company (MC), preferential tax policies, subsidies and other preferential treatments, investability by certain LPs, among others. In fund formation practice, the distinction between PE and VC funds may significantly complicate the structuring process, as discussed later. The effectiveness of the amended Securities Investment Funds Law (SIFL), the first national level legislation on PE/VC funds, on 1 June 2013 and other regulations in the works may help harmonise the differences in the regulation on PE and VC funds to some extent over time.

i Domestic sponsors and investors

PE funds raising capital exclusively from domestic investors may be structured as limited partnerships (LLPs)[8] under the Partnership Enterprise Law or limited liability companies (LLCs) under the Companies Law and other national and local regulations. While many Chinese LPs, especially state-owned enterprises (SOE), were (and still are) more familiar and comfortable with LLCs, LLPs have gradually become the dominant form for PE funds in general in recent years.

Under the Partnership Enterprise Law, an LLP may have up to 50 partners, including at least one general partner (GP) and one limited partner (LP). The number of shareholders of an LLC likewise is limited to 50 under the Companies Law. The limit on the number of investors is a significant constraint on certain funds. Chinese fund of funds (FoF) managers, for example, typically rely on high-net-worth individuals as their main LP base and often have to set up multiple parallel funds in order to stay in compliance with the 50-partner or shareholder limit. Such limit may also create a significant challenge for fund managers that seek to raise capital from FoFs or other similar collective pools of capital (such as trust plans and asset management schemes) as they may be subject to look-through rules for purposes of calculating the number of investors and determining investor qualification. Careful planning is thus crucial in those circumstances.

6 The NDRC, for a short period of time, also regulated PE funds through its mandatory record-filing regulation.

7 The minimum size for VC funds is 30 million renminbi. The minimum size for PE funds may vary depending on the specific location of formation of the PE fund, with the typical requirement being 100 million renminbi.

8 'LLP' (limited liability partnership) is customarily used as the acronym for 'limited partnership' to distinguish it from 'LP', which usually refers to 'limited partner'.

ii Foreign investors

The form of fund with foreign participation (either as GP or investors or both) has evolved over the years.

Foreign-Invested Venture Capital Enterprise (FIVCE)

Before the advent of the LLP in China, foreign fund sponsors primarily formed onshore funds in China in the form of 'foreign-invested venture capital enterprise' (FIVCE) under the Administrative Regulation for Foreign-Invested Venture Capital Enterprises (the FIVCE Regulation) promulgated on 30 January 2003. An FIVCE may be set up either as a 'non-legal-person sino-foreign cooperative joint venture' (Non-Legal-Person FIVCE) or as an LLC (Corporate FIVCE). A Corporate FIVCE is typically used by one or more foreign fund sponsors to set up an onshore fund exclusively with foreign currency capital, whereas Non-Legal-Person FIVCE was the popular form for a foreign fund sponsor to pool onshore and offshore capital together, often in partnership with a Chinese fund sponsor.

An FIVCE (whether in non-legal-person or corporate form) is required to have a 'requisite investor', which plays the role similar to a GP to a partnership fund. The requisite investor is required to satisfy certain requirements, including: (1) having venture capital investment as its main line of business; (2) having cumulative capital under management of at least US$100 million (or 100 million renminbi in the case of a Chinese investor acting as the requisite investor) in the most recent three years; and (3) subscribing for and contributing at least 1 per cent (in the case of a Non-Legal-Person FIVCE) or 30 per cent (in the case of a Corporate FIVCE) of the total size of the FIVCE.

A FIVCE is required to have a minimum fund size of US$5 million or the renminbi equivalent (in the case of a Corporate FIVCE) and US$10 million or the renminbi equivalent (in the case of a Non-Legal-Person FIVCE). Each investor other than the requisite investor is required to invest at least US$1 million or renminbi equivalent.

The Non-Legal-Person FIVCE was very popular before the advent of LLP because it was the legal form closest to an LLP. The FIVCE Regulation allows the investors of a Non-Legal-Person FIVCE to agree for the requisite investor to assume joint liability to the FIVICE and the other investors to assume limited liability up to their capital commitments (in contrast, all investors of a Corporate FIVCE enjoy limited liability protection). Non-Legal-Person FIVCEs were also allowed to choose to be a tax pass-through entity like a partnership, in which case income of the FIVCIE will not be taxed at the fund level but will be allocated and directly taxed to the investors. The tax pass-through treatment, however, was not well understood by many local tax authorities, causing many Non-Legal-Person FIVCEs to not be able to enjoy tax pass-through status in many local jurisdictions. As the LLP form was made available to foreign-invested PE funds in 2010 and the provision granting tax pass-through status to Non-Legal-Person FIVCEs was officially repealed in 2011, FIVCE became a much less desirable legal form for foreign-invested funds in China. Certain foreign sponsors have decided to dissolve FIVCEs if such funds have not made substantial investments or their investments have not significantly appreciated in value. To the extent that such dissolution or restructuring requires the transfer of investments to an LLP established by the same group of investors, it unfortunately would trigger enterprise income tax (EIT) as it would be unlikely to

qualify as a tax-free reorganisation. Other foreign sponsors have been exploring ways to restructure FIVCEs into LLPs without transfering the underlying portfolio interests. However, as there is currently no law or regulation authorising the restructuring of FIVCEs into LLPs[9], it can only be done on a case-by-case basis (if at all). To our knowledge, so far there has been no successful case of such restructuring.

Qualified foreign limited partner (QFLP) and renminbi-QFLP (R-QFLP)

As discussed earlier, the Partnership Enterprise Law was amended in 2006 to permit the limited partnership form, which spurred the growth of domestic limited partnerships (DLP). As foreign investment and foreign exchange is tightly regulated in China, however, foreign fund sponsors and investors had not been able to avail themselves of the new LLP structure until the State Administration of Industry and Commerce (SAIC) promulgated the Administrative Regulations on the Registration of Foreign-invested Partnership Enterprises (the FLP Regulations) in 2010 and Shanghai released trial regulations on its QFLP Pilot Programme in January 2011.[10] The pilot programme opens the door for foreign sponsors to set up onshore funds in China in the form of LLP and brings clear advantages over the traditional FIVCE or offshore fund model. In particular, in contrast to a FIVCE, which is now subject to a 25 per cent EIT, a QFLP fund as a partnership enjoys tax pass-through treatment at the fund level. Second, an offshore fund needs to go through the time-consuming approval process with the State Administration of Foreign Exchange (SAFE) for each investment and the portfolio company would receive foreign currency capital from the fund and has to seek SAFE approval to convert it on each occasion when it needs to use such capital. In contrast, SAFE approval for a QFLP fund is done at the front end, namely, at the time of the fund formation, and foreign currency capital may be converted into renminbi directly with the custodian bank in a swift manner (typically about one week), thus avoiding the lengthy SAFE approval for each investment and also saving the portfolio company the trouble of having to seek SAFE approval for foreign exchange settlement. For those fund sponsors that did not manage an onshore fund before, a QFLP fund could also bring certain reputational and other intangible benefits. To date, about 30 foreign sponsors have received QFLP licences for their PE funds in Shanghai, including leading PE firms such as Blackstone, Carlyle, TPG, 3i, Hony Capital and SAIF.

Over the past few years, three main models have emerged for QFLP funds: (1) the DLP model, where the foreign fund sponsor sets up a wholly foreign-owned enterprise (WFOE) to act as the GP/MC of a DLP and raises capital solely from domestic investors

9 In comparison, certain local authorities (e.g., Shanghai Pudong District) introduced local regulations permitting the restructuring of an LLC into an LLP. Due to the lack of implementing rules, however, the restructuring is only done on a case-by-case basis in practice.

10 Beijing, Tianjin, Chongqing and Shenzhen followed suite in adopting their own versions of the QFLP Pilot Programme, which were all modeled after the Shanghai version. Among all cities with a QFLP pilot programme, the Shanghai programme is by far the most successful one.

in renminbi (as exemplified by the Blackstone QFLP fund);[11] (2) the Co-GP/Joint Venture FLP model, where the foreign fund sponsor partners up with a Chinese fund sponsor to set up a joint venture MC and raises capital from both domestic and offshore investors (as exemplified by the Carlyle-Fosun QFLP fund); and (3) the Wholly Foreign-Owned FLP model (as exemplified by the Fidelity QFLP fund). For each model, there are different variations, and the QFLP Pilot Programme is quite flexible in accommodating such variations. QFLP funds and their MCs are required to include 'equity investment' and 'equity investment management' in their company names and business scope and thus are PE funds. Sometimes, the foreign sponsor of a QFLP fund also intends to raise capital from capital pools administered by the NDRC or its local counterparts, which is an example when the incompatibility between the two lines of regulations over PE and VC funds becomes particularly obvious and poses a significant structuring challenge to the fund sponsor and its counsel.

The nature of a QFLP fund as a domestic or foreign fund is also an important issue. Under Chinese law, it is very clear the QFLP funds under models (2) and (3) above are deemed foreign investors in terms of their investments and are required to go through the same foreign investment approval process as an offshore fund (except for the differences in foreign exchange approval and conversion process as described earlier). The nature of a QFLP fund under model (1) above, however, is less than clear. The Shanghai QFLP regulation was designed by the Shanghai Financial Services Office (SSFO) to permit a QFLP fund that raises capital exclusively from Chinese investors in renminbi and whose foreign element is limited to the capital commitment/contribution by the GP (in the form of a WFOE or other foreign-invested enterprise (FIE)) to the fund of up to 5 per cent of the fund size to be treated as a purely domestic Renminbi fund free from any foreign investment restrictions. The Blackstone QFLP fund was structured exactly to fit into such exception. However, the hope of domestic treatment was dealt a big blow by a written reply from the NDRC to its local counterpart in Shanghai on the classification of the Blackstone QFLP fund in April 2012, which clearly provides that the investments by such funds still need to comply with the Foreign Investment Industries Guidance Catalogue (e.g., with respect to the prohibition against and restrictions on certain industries, even though such fund is issued a business licence as a DLP rather than an FLP and the portfolio company is not required to be converted to an FIE). Following the NDRC Blackstone reply, new structures have been developed to minimise the adverse impact of such reply on the investment of similarly situated funds.

Another variation of the QFLP fund is the R-QFLP fund, where offshore renminbi as opposed to foreign currency capital is used to set up the fund. The R-QFLP Pilot Programme has been less successful, partly because it is subject to the additional regulation by the People's Bank of China with respect to the use of offshore renminbi by the fund. To date, only two R-QFLP funds have been set up in Shanghai.

11 Even though this structure does not involve a foreign LP, the management company and the fund still need to apply for QFLP licences because PRC law would otherwise prohibit the FIE-MC from using its foreign currency registered capital to make its GP commitment/contribution to the fund.

Important variation

It is very common for foreign sponsors to seek to raise capital exclusively from PRC investors in renminbi, namely, under model (1) above. To avoid the time-consuming process of applying for a QFLP licence and foreign investment restrictions, it is desirable for such foreign sponsor to set up a pure DLP without any foreign investment restrictions. One way to structure a pure DLP is to use Chinese nationals (e.g., Chinese members of the team) to set up a purely domestic LLC and putting a series of contractual arrangements in place between the GP and the WFOE-MC. Careful advance legal and tax planning are required to ensure that such contractual arrangements provide effective control over the GP and are enforceable under PRC law and that the economics of the fund (e.g., carried interest and management fee) are structured in a way consistent with the commercial intentions of the fund sponsor.

iii Limited partners

Compared to the LP market in the developed countries, China's LP market still remains at a primitive stage. Currently, the main LPs for the PE market in China are the National Social Security Fund Council (NSSFC), SOEs, insurance companies, successful entrepreneurs and high-net-worth individuals, third party wealth management firms and FoFs. College endowments and foundations are still in their infancy and are not major players in the field, and local and corporate pension funds are not yet permitted to invest in PE funds.

In comparison with mature PE markets where the GP-LP model is more developed and the boundaries between GP and LP are highly respected, in China such boundaries are less clear. LPs (especially successful entrepreneurs) often desire to get significantly involved in the investment process of the fund by way of a seat on the investment committee or veto right with respect to investments. Such involvement is risky as LPs may lose their limited liability protection under Chinese law by participating in the investment and management of the fund. However, as there has been no reported case against an overly active LP yet, such risk has not been sufficiently appreciated.

SOEs are a major source of capital for PE funds, and in recent years, they have also become active in seeking to act as the GP, either alone or in partnership with other parties. The participation of SOEs as GP or LPs in a fund creates a myriad of issues. For example, SOEs are expressly prohibited from acting as GP under the Chinese Partnership Enterprise Law. It is unclear, however, what constitutes an SOE for the purposes of this prohibition, and different government agencies apply different standards. According to the SAIC definition, SOEs only refer to wholly state-owned entities, while NDRC considers SOEs to be all types of entities where the direct or indirect aggregate state ownership is no less than 50 per cent. Another important issue is the obligation of state-owned shareholders (SOSs) to mandatorily transfer (for free) up to 10 per cent of the issued shares of their portfolio company to the NSSFC upon its IPO. A fund with a significant level of expected SOE participation should determine in advance whether it may be deemed an SOS subject to the mandatory transfer requirements, and the rules for determining such SOS status are less than clear and not consistently applied. If significant state ownership cannot be avoided, provisions should be built into the

partnership agreement and other documents to ensure that other non-SOE LPs and the GP will be made whole by the SOE LPs for the impact on their economic interests.

For first-tier PE sponsors, the deep-pocketed LPs to go after in fundraising in China are the NSSFC and insurance companies. Since May 2008, the NSSFC has been permitted to allocate up to 10 per cent of its assets (the equivalent of about US$200 (as at the end of 2013)) to domestic PE funds (investments in offshore PE funds are not yet permitted). Chinese insurance companies have also been allowed to invest up to 10 per cent of their total assets in both domestic and offshore PE funds since 2010, but they are not allowed to invest in VC funds.

For most of the fund sponsors, LPs like the NSSFC or insurance companies are beyond their reach. With the rapid growth of high-net-worth individuals and the wealthy middle class in China, asset and wealth management firms such as trust companies, brokerage firms, mutual funds or asset management subsidiaries and third-party wealth management firms are playing an increasingly important role in the fundraising of PE funds. The involvement of such asset and wealth management firms may significantly complicate the fund formation process as they are subject to different regulations by different regulators, and requirements for investor suitability are inconsistent across different types of firms. Trust companies are regulated by the China Banking Regulatory Commission (CBRC), brokerage firms and mutual funds and asset management subsidiaries are regulated by the China Securities Regulatory Commission (CSRC), while third-party wealth management firms remain largely unregulated. Whether and to what extent such asset management schemes should be looked through for investor suitability and determination of the number of investors remains unsettled, and regulatory arbitrage is common in the structuring of some of such funds.

iv Taxation

Tax is critical to the fund structuring process in China, even more so than in other developed countries as tax rules with respect to PE funds and their partners are less settled and the room for tax planning and the downside for lack of or inappropriate tax planning may be more significant than in more developed countries.

Under Chinese tax law, dividend income between two LLCs is exempt from EIT in order to avoid double corporate taxation (Inter-LLC Dividend Exemption). For the same reason, dividend income from a corporate PE Fund to an investor that is an LLC (a corporate investor) is also exempt from EIT. Since a fund typically receives most of its income from the disposition of portfolio interests, which is then allocated and distributed to its partners, for a corporate investor, it is indifferent as to whether the fund is an LLC or an LLP as far as EIT is concerned because only one layer of EIT will be incurred, either at the corporate PE fund level or at the corporate investor level.

Individual investors, on the other hand, care deeply about the form of the fund. Individual investors are generally subject to individual income tax (IIT) at a rate of 20 per cent with respect to investment returns from the fund.[12] Since a fund in the LLC

12 It is clear that dividend income to an individual investor from an LLC fund shall be taxed at a 20 per cent IIT rate. It is less clear whether income from the disposition of portfolio interests

form would be subject to an additional layer of tax (EIT) on its income from the sale of portfolio interests, LLP funds are clearly more tax efficient to individual investors as well as other entity LPs (such as an FoF in LLP form) that are comprised primarily of individual investors.

In the case of an FLP, withholding tax (WHT) at a rate of 10 per cent shall apply to dividend income from the FLP to an offshore partner, including carried interest to the offshore GP.[13] Such WHT may be reduced to 5 per cent if the offshore partner is able to avail itself of such reduced WHT pursuant to a tax treaty between China and the jurisdiction of formation of the foreign partner.

Corporate FIVCEs that are duly registered with the NDRC enjoy special preferential tax treatment. If they hold investments in qualified small or medium-sized companies with a high-tech qualification certificate for a period of at least two years, they are permitted to apply 70 per cent of its total investment amount in such qualified companies to offset their taxable income, with any excess carried forward to subsequent years.

III REGULATORY DEVELOPMENTS

After a fierce turf war that lasted for several years, the principal regulator for the PE/VC industry, NDRC, ceded its regulatory power over PE/VC funds to CSRC in July 2013. CSRC delegated much of the regulatory function to the newly established Asset Management Association of China (AMAC), the self-regulatory organisation of the fund industry in China. On 17 January 2014, AMAC released the Interim Measures on the Administration of Registration of Non-publicly Raised Investment Fund Managers and Record-filing of Funds (the Measures), effective as of 7 February 2014. The Measures cover all types of privately raised investment funds (regardless of whether they are set up as PE or VC funds), hedge funds and their managers.

Pursuant to the Measures, any private fund manager is required to register with AMAC and conduct record-filing with AMAC for the private fund within 20 days after the closing of such fund. All existing private fund managers and private funds (including PE, VC and hedge funds) are required to register with AMAC by 30 April 2014, and those who fail to register by such date risk being subject to sanctions by

received by an LLP fund and allocated to an individual investor is also subject to 20 per cent IIT. A number of provincial regulations provide for 20 per cent IIT on such disposition income from an LLP fund, even though some national tax rules that predated the limited partnership legislation, read literally, would require such income to be taxed at a progressive 5–35 per cent rate, which is often less favourable to individual investors.

13 The 10 per cent WHT to the offshore GP assumes that such offshore GP is not deemed to have a 'permanent establishment' in China. If such offshore GP is deemed to have a 'permanent establishment' in China, then it will be subject to the 25 per cent EIT. Further, if carried interest is deemed service income rather than investment income by the relevant tax authority, it will be subject to business tax and ancillary tax at the rate of 5.6 per cent on the gross amount of the carried interest.

CSRC. Some basic information regarding the fund, such as the name of the fund, date of establishment, major field of investment, fund manager and custodian, is required to be provided to AMAC through its electronic record filing system. The private fund manager shall also update information on PE funds (such as total amount of commitment and contribution, total number of investors and change in the fund's investment focus) on a quarterly basis and on the manager itself on an annual basis. Fund managers are also required to report to AMAC a series of significant matters, such as any change in senior management, controlling shareholder of the private fund manager, merger, division, bankruptcy of the private fund manager, significant amendment to the fund agreement and liquidation of the fund. Further regulations on private funds are also in the works.

V NOTEWORTHY DEVELOPMENTS

i Shanghai Pilot Free Trade Zone

The China (Shanghai) Pilot Free Trade Zone (FTZ) was officially launched on 29 September 2013 with the purposes of reducing restrictions on foreign investment, encouraging outbound investments, further opening the domestic capital market for foreign investors and accelerating the liberalisation of interest rates, which is good news for domestic and foreign PE firms in general. As the FTZ encompasses reform initiatives in many areas, the detailed implementing rules will only come out over time. To date, it is clear that for outbound-focused funds, choosing to be formed in the FTZ brings significant advantages as the traditional outbound investment approval process (the NDRC, then SAFE, then MOFCOM), which typically takes at least three to four months if not more, is changed to a record filing process in most cases, thus reducing the uncertainty of the regulatory approval as well as the length of the process. It remains to be seen how other types of domestic and foreign PE firms can take advantage of the FTZ.

ii Other developments

Going into 2014, most of the funds raised during in the 2006–2008 PE peak time are reaching the end of their terms, and GPs are under pressure to show returns to investors. It has been reported that PE firms still have 7,500 disclosed domestic portfolio companies in their portfolios. During the 14-month period between November 2012 and January 2014 when CSRC placed a moratorium on IPOs, sale to other PE funds and strategic buyers emerged as a more attractive option for PE/VC funds. LP defaults have also been on the rise following the global financial crisis. A number of local governments set up trading platforms to facilitate the secondary sale of LP interests and portfolio interests among renminbi PE/VC funds and their investors, but with limited success to date. Most buyers in the secondary PE market are inclined to purchase portfolio interests rather than LP interests in the funds as the latter is much harder to value and potential sellers of portfolio interests or fund interests shun publicity associated with using the secondary trading platforms.

VI OUTLOOK

As a concept learned from the western world, the PE and VC market in China has been growing in a phenomenal way in the past 20 years and helped create many of the leading companies in China. At the same time, such phenomenal growth of the industry also prompted myriad business and legal issues, some of which are unique to China. Chinese laws and regulations lagged seriously behind the development of the industry in many respects and are also characteristically vague in many others, and the regulators are trying hard to play catch-up while protecting their own turf. It is a most dynamic market in which the law changes much faster than in developed countries and great opportunities and great challenges coexist.

Appendix 1

ABOUT THE AUTHORS

JAMES YONG WANG
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James Wang has over a decade of experience in the investment funds and asset/wealth management field. James represented international and Chinese fund clients in the structuring of over 100 domestic and offshore PE/VC/hedge/real estate/mezzanine/film and media/energy/infrastructure funds, QFLP/R-QFLP funds, QDLP funds, QFII/R-QFII funds and QDII funds with total capital commitments in excess of US$30 billion equivalent. James also regularly represents trust companies, broker/dealers, mutual funds, insurance companies and wealth management companies in joint venture and partnership transactions, M&A transactions and the structuring and issuance of various asset/wealth management products. James has been consistently ranked as a 'Leader in Investment Funds for China' by *Chambers* and *IFLR*, as well as one of the Top-15 Rising Lawyers in China by *Asian Legal Business*. James is a member of the Expert Review Committee of the QFLP and QDLP Pilot Programmes administered by Shanghai Financial Services Office and also served as advisor to it on PE secondary market initiatives. James is also active in PE/VC investments, M&A and capital markets transactions. Prior to Han Kun, James worked at several major international law firms in the U.S. and China and was a partner at a major international law firm in New York.

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