

Construction of Research Framework on Legal Issues of Foreign Private Equity Fund Supervision

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Abstract: Earlier, the United States was the first country to set up private equity funds. By setting up investment institutions to raise funds from the rich for investment in high-tech small and medium-sized enterprises, with the gradual development, private equity funds became one of the financing channels for small and medium-sized enterprises, and gradually became an important part of the American financial system. The introduction of private equity funds in China was in the early stage of reform and opening up. With decades of changes, the private equity fund industry has gradually developed in China. However, there are still some legal problems to be solved in the supervision of foreign private equity funds. At present, the loss of foreign private equity fund institutions and irresponsible fund managers still occur from time to time, which is not conducive to promoting China's economic reform and enterprise innovation and management. It will even have a certain impact on China's economic development order. The supervision of foreign private equity funds is an important way to raise funds in China. It is necessary to strengthen the effective supervision of foreign private equity funds and increase legal research.

Keywords: foreign capital; Private equity fund; Legal issues of supervision

1. Introduction

Nowadays, private equity has developed in China for many years, and foreign countries have established a relatively perfect operation system for private equity funds. Compared with foreign countries, China's attempts on private equity are still short, and the relevant laws and regulations are very different from those of foreign countries. The introduction of overseas private equity funds into China has led to conflicts between its mature foreign systems and Chinese laws and regulations. Therefore, this thesis focuses on the research and exploration of the legal issues of foreign private funds supervision, and formulates corresponding optimization strategies based on foreign institutional basis. In the process of foreign equity access, managers and investors have different needs, and even set up a pilot policy of qualified overseas limited partners to increase the advantages of foreign equity. In the actual investment operation, foreign equity funds are often carried out in the form of limited partnership. However, due to the restrictions of Chinese laws, limited partnership has been restricted in China, which has spawned some problems. It is necessary to conduct in-depth research to create a good domestic operating environment for foreign private equity funds.

2. The Concept and Necessity of Supervision of Foreign Private Equity Funds.

Private equity funds are commonly expressed by the English abbreviation PE, that is, collecting from specific targets in a non-public way, injecting them into unlisted enterprises and obtaining equity. During the period of rights and interests, the time limit is agreed, and the invested enterprise is at maturity, so as to obtain profits through this investment model. From the characteristics of private equity fund, it is non-public, which is obviously different from the public way of issuing stocks and bonds. At the same time, it is different from the commonly used investment objects such as bond investment and bank loans, and is actually equity investment. To draw a conclusion, private equity investment belongs to the private type of fund-raising, while fund-raising is specific; it belongs to investment, which mostly invests in unlisted high-growth enterprises; it has a long investment period; it points the exit link. ^[1].

Nowadays, China's economic level has improved significantly, and many foreign private equity funds have begun to appear in China market. According to the relevant provisions of Chinese government policies and corresponding regulatory measures, foreign PE has formed a two-pronged

operation mode, so it is necessary to implement refined supervision to promote the stable operation of PE and inject fresh vitality into the market economy. Foreign PE itself has more mature investment experience, and its selected investment projects can often guide other investors in China and are favored by mass investors, thus concentrating funds in a certain field and inhibiting the promotion of other industries and projects. In addition, foreign PE will often enter the Chinese market with political purposes, so we need to be vigilant. At the same time, once a large number of foreign capital PE are introduced, it will lead to a certain industry being controlled by foreign capital, disrupt the market competition order, promote changes in the core technologies of enterprises, and weaken the R&D and innovation capabilities of domestic enterprises. At the moment, the red-chip model of foreign-funded PE in China is not explicitly prohibited by relevant laws. The fundraising, investment and withdrawal of foreign-funded PE are all done overseas, bypassing domestic supervision, which is not conducive to China's supervision of foreign-funded PE. China's laws do not specify the procedures for access and withdrawal of foreign-funded PE in detail, and there are many shortcomings in actual operation, which need to be further filled in legal loopholes. Foreign capital PE plays a positive role in promoting China's economic market. Doing a good job in supervision of foreign capital PE is helpful to ensure domestic economic security, optimize industrial structure and promote the stable operation of enterprises. We should pay more attention to this link.

3. The Legal Dilemma of Foreign Private Placement Access Supervision

3.1 Scattered supervision, rules are not uniform.

Foreign investment is an important means to promote the national economic development. In order to comply with the national economic development policy and ensure foreign investment, China has set corresponding regulations for foreign-related content of foreign investment. For example, the Foreign Investment Law contains some relevant regulations. However, the Foreign Investment Law only abolishes the foreign-funded enterprise law, and can actually change the relevant provisions of foreign venture capital enterprises and foreign-funded PE. Therefore, China adopts separate haircuts in establishing and investing foreign-funded private equity funds, and there are higher requirements and thresholds for the establishment of domestic-funded private equity funds. In order to avoid government restrictions, various measures are often taken for foreign-funded PE, which increases the difficulty of supervision of foreign-funded PE in China [2]. In addition, the application of private equity funds in China has only been established for more than 20 years, and there is no perfect law yet. The national legislation related to foreign private equity funds is mostly composed of scattered pieces of regulations. At the same time, laws and regulations are not coordinated at different levels at the national and local levels, resulting in different compliance requirements for foreign PE, and the specific practice links are very uncertain. However, there is no unified standard in the pilot project of qualified overseas limited partner system, which affects the rational application and implementation of national preferential policies.

3.2 Challenges brought by foreign private equity fund access filing system

In order to ensure the quality of foreign capital introduction, China usually determines the foreign capital access by case examination and approval, and controls the foreign capital PE access by examination and approval system. This way is helpful to strengthen the quality of foreign capital introduction and provide guarantee for the national economy. However, with the rapid development of market economy, the examination and approval system is no longer applicable to the current trend, and it will also inhibit the development of foreign PE. In 2016, China began to implement the Interim Measures for the Administration of Filing the Establishment and Change of Foreign-invested Enterprises, and carried out filing management. On March 15, 2019, China adjusted the Foreign Investment Law, abolished the case-by-case examination and approval system, and implemented the negative list management model. If the foreign investment involved is no longer on the negative list, the filing system is encouraged. Compared with the examination and approval system, this method has simpler procedures and can introduce more overseas funds for China and set up foreign-invested enterprises. However, there are also problems in the implementation of the filing system. This mechanism attaches importance to the supervision during and after the event, and the filing institution needs to play a procuratorial role and do a good job in the supervision during and after the event [3]. At the same time, cooperate with customs, taxation, foreign exchange and other relevant departments, strictly supervise the illegal acts of foreign-invested enterprises, notify the relevant departments to each

other, do a good job in verifying the notified matters, clarify the responsibilities of each department and implement orderly management.

3.3 Pre-entry national treatment and problems in the negative list system

In view of the relevant regulations on QFLP in various regions of China, the relevant contents formulated in Shenzhen in 2017 did not include the issue of “national treatment clause”, while the relevant policies in Shanghai included more provisions on national treatment before entry. The Foreign Investment Law, which was implemented on March 15, 2019, began to implement negative list management for foreign investment access, and the foreign investment included in the negative list was still subject to case-by-case examination and approval, which was not negative. With the abolition of the “Three Laws on Foreign Investment” by law, the examination and approval of restricted foreign investment has lost its legal basis, and the state needs to rectify and improve the relevant management measures. Meanwhile, the Foreign Investment Law contains provisions on the implementation of national treatment before entry. It is necessary to set up a negative list, in which the host country should clearly list the restricted areas. Finally, it provides guarantee for national treatment before entry. Finally, in view of the pre-entry national treatment and negative list, the government is also required to announce the legal norms and specific conditions of foreign investment, and build a transparent and fair environment to facilitate the implementation of relevant measures.

4. The Legal System Construction of Foreign Private Equity Fund Access Supervision.

4.1 Improve the problem of decentralized supervision and realize the unified integration of supervision.

The legislative system established for foreign private equity funds is mainly composed of domestic economic law and foreign-related economic law, so as to coordinate the investment relationship between domestic enterprises and foreign-invested enterprises. However, hierarchical differences will lead to legislative conflicts, and it is impossible to effectively cooperate with foreign PE investors and managers, thus inhibiting the development of funds. In order to ensure the reasonable and high-quality legislation, it is necessary to pay attention to the hierarchical relationship of foreign PE laws, implement the unification of access conditions, accordingly improve the level and efficiency of supervision. With the implementation of Foreign Investment Law, the process of national unified legislative supervision has moved forward, but in order to coordinate the regulations of foreign PE reasonably, it needs to be strengthened and supplemented.

4.2 Give full play to the role of trade associations in market access.

At the present stage, China has begun to change into a filing management mode in view of the restrictions on foreign capital access, but there are still strict requirements for foreign-funded enterprises to invest in fundraising methods after entering the industry. There are obvious differences between foreign PE and domestic PE, because the special nature may bring some political factors. In order to ensure the safe and stable development of China's economy, it is necessary to strictly supervise the access of foreign PE. Combined with foreign practice, it is necessary to introduce the function of trade association on the basis of giving full play to the role of government departments, so that it can play an auxiliary regulatory role, provide assistance to the regulatory work with the professional advantages and information mastery of the association, and give full play to the role of trade association in the supervision of newly established foreign-funded PE during and after the event, so as to identify illegal acts in time and report them to the competent authorities. Reduce the official nature of the association, realize the autonomy of trade associations, increase the efficiency of government supervision, reduce the situation of foreign PE finding legal loopholes, and optimize the supervision policy.

4.3 Entry Criteria for Foreign Investors with Regular Articles

At the moment, China has established the standard of qualified investors, so as to strengthen the supervision quality of foreign PE investors, and investors need to meet the corresponding financial assets and investment experience. Currently, China's economy is developing at a high speed, and the asset standards for qualified investors are constantly improving. Due to changes such as rising prices

and economic development, the previous standards and the current application rate are declining. Therefore, China can learn from the theoretical experience of Dodd-Frank Act of the United States and let relevant institutions adjust the asset standards regularly according to the economic situation and investment environment. For foreign-funded PE, only enterprises with foreign-funded capital need to operate and manage in accordance with the regulations. In fact, foreign-funded PE is mostly restricted, and it is subject to a series of restrictions such as foreign exchange control and investment industry from the fundraising stage, thus inhibiting the introduction and development of foreign investors^[4]. To this end, China has introduced the “Qualified Foreign Investor” system, and conducted pilot projects in Beijing, Tianjin, Shanghai and Shenzhen to introduce more foreign capital to the PE market. This system mainly plays the role of encouraging foreign investment, and at the same time, it can improve the efficiency of foreign investment supervision in China and reduce the situation that investors take measures to avoid China’s policy supervision.

4.4 Establish the manager’s credit system

This thesis analyzes the construction of regulatory measures and policies for managers in the United States and Britain, which mainly focuses on managers’ credit, while China’s supervision focuses on the restrictive requirements such as managers’ access conditions and working experience, and there are no relevant regulations and records on credit, and there is a lack of specific fiduciary business regulations. In order to improve the current shortcomings in China, it is necessary to learn from foreign experience, try our best to improve managers’ credit system, and include managers’ performance and reputation in the assessment scope to ensure mutual coordination and promotion. In fact, managers with high credit and good reputation are often more likely to raise funds and improve their performance. At the same time, they will also help attract investors, and managers will be able to abide by their fiduciary obligations and establish a virtuous circle. As for the supervision of managers’ access, the performance and reputation over the years are convenient for reasonable screening. At the moment, some documents in China also have provisions on the fiduciary duty of fund managers, but the specific practice is relatively difficult. It is necessary to further optimize and improve the credit system and focus on improving the normative requirements for credit and reputation^[5].

4.5 Suggestions on perfecting the taxation and foreign exchange supervision system of foreign private equity funds

First of all, we should improve the foreign exchange management and supervision system. Currently, the relevant legal system stipulates that foreign-invested enterprises can directly use RMB funds obtained from foreign exchange settlement for domestic equity investment, which further brings preferential treatment to foreign PE, promotes cost saving and facilitates the introduction of more investors. However, there are many problems in the supervision of foreign exchange PE capital flow in China, and foreign PE often uses means to avoid the foreign exchange supervision of our government, which increases the difficulty of foreign exchange supervision. We must establish and improve the foreign exchange supervision system in combination with practical problems to prevent the unclear flow of funds from affecting the stable operation of China’s economy. Banks must vigorously supervise the flow of foreign exchange settlement funds. For the moment, the supervision of banks is weak, and many reviews remain superficial. Therefore, it is necessary to make the banking supervision function clear, effectively supervise the investment of foreign-invested enterprises’ foreign exchange settlement funds, and collect information and data of their investment projects for reporting, so as to determine the real flow of funds and ensure safety. Secondly, it is necessary to improve the tax policy of foreign private equity funds. First, do a good job in tax policy innovation, such as determining the investment deduction based on the investment period. If the period is long, more deductions can be obtained and the tax burden can be reduced.

For example, referring to the American tax law, the capital gains of assets held for one year and more than one year are taxed at different tax rates, and the longer they are held, the lower the tax rate^[6]. By imitating this regulation, we can improve the long-term and stability of venture capital; Secondly, it is necessary to strengthen the investment tax incentives in the initial stage of enterprises and do a good job in supporting them during the development period, so as to introduce more foreign capital and promote the development of enterprises; Finally, formulate and improve the tax deduction policy and expand the scope of application. Foreign-funded PE is not only focused on investing in small and medium-sized high-tech enterprises, it is necessary to further broaden the definition criteria of small and medium-sized high-tech enterprises and increase the scope of application of the deduction policy

for introducing more foreign capital.

5. Conclusion

In China's economic market, private equity fund is a common financing tool, which helps to promote the development of China's small and medium-sized enterprises. It is necessary to strengthen the effective use of private equity funds. As far as foreign private equity funds are concerned, due to their special attributes, they are currently facing three regulatory dilemmas in China, such as access, investment and withdrawal. The legal basis for this is still insufficient and the actual binding is too high, which increases the situation that foreign-invested enterprises evade legal supervision by means, resulting in ineffective supervision and affecting the stable development of China's economy. As far as specific issues are concerned, there are mainly some problems, such as foreign-funded PE can't enjoy domestic treatment after entering China, foreign exchange and tax policy preferences are insufficient, multi-level capital market is not perfect, and various legal systems are imperfect and inflexible. Therefore, it is necessary to optimize the legal system in combination with practical problems, and at the same time relax the access standards appropriately, so as to attract more investors, promote enterprise development, create a healthy and harmonious policy environment, improve the capital market, and establish and improve relevant legal systems while ensuring the safety of foreign capital in China's economic development. Only in this way can we promote the effective establishment and investment of foreign private equity funds in China and bring more benefits to China.

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