The Improvement of the Legal Protection System for Private Equity Investors in China

Huanchen Zhang [a, *]

Shenyang No.120 High School, Hengshan Road, Shenyang, China

[a]. ReiAiri11285@STUDENT.WUST.EDU.PL

* Corresponding Author Email: corresponding author

Abstract. Private equity has become more common in recent years, and the number of investors involved is increasing. Participating in private equity investment can be very profitable, but there are also high risks, how to effectively prevent investors from encountering risks and ensure the good development of the industry is an important issue in front of us. The reason why private equity investors are vulnerable to risks is mainly due to two reasons, on the one hand, the high degree of information asymmetry in this activity, and on the other hand, because of the problems in China's relevant legal protection system, which is not yet perfect. Although China has promulgated some laws and regulations on the protection of the interests of private equity investors, there are still many loopholes in these laws and regulations, and they need to be improved, based on this, this article summarizes the problems existing in China's legal protection system for private equity investors, and puts forward suggestions for improving these problems, hoping to provide reference for relevant people.

Keywords: Private equity investors, Legal protection, System, Improvement.

1. Introduction

Since the implementation of reform and opening up, China's economy has advanced rapidly, and the wealth in people's hands is also increasing, which makes their investment awareness more and more intense, coupled with the opening up of national policies, investment forms have become more and more diverse, private equity investment is in this situation. In recent years, this form of investment has been accepted by more and more people in China, its development momentum is good, and at the same time promote China's economic development, but because the law is behind the times, this form of investment has caused many legal problems, and the law can not provide comprehensive protection for private equity investors.

2. Meaning of Investors in Private Equity Investment Funds

Private equity investment fund investors refer to a class of professional investors who participate in the fund's investment activities by purchasing shares in private equity investment funds. Private equity investment fund is a fund composed of highly qualified investors, which mainly invests in non-listed companies or non-public equity of listed companies [1]. In addition, private equity investment fund investors also need to comply with relevant laws and regulations, such as the Securities Investment Fund Law and the Measures for the Administration of Private Equity Funds. In the investment process, private equity fund investors need to take certain risks, but it is also possible to obtain large returns. Please remember that all the papers must be in English and without orthographic errors.

3. Problems in the Legal Protection System for Investors in China's Private Equity Investment Funds

3.1. Lack of Investment Ratio Restrictions, Unable to Ensure the Risk-bearing Ability of Qualified Investors

The introduction of fixed investment entrance standards is aimed at selecting adequate financial investors to prevent those with insufficient funds from bearing the consequences of investment failure. For private equity investment funds, it is not suitable for "poor people" to participate, as it is a game exclusively for the wealthy. The implementation of fixed investment entrance standards can only ensure that "poor people" do not participate, but cannot prevent the wealthy from risking all their assets and ultimately leading to bankruptcy. Fixed investment entrance standards only specify the specific income of investors participating in private equity investment, but cannot fully evaluate and limit investors' risk tolerance, which may lead to some investors with insufficient risk tolerance investing all their funds in private equity investment funds. For example, if an investor meets the required investment standard but invests all their income for the last three years in private equity investment and has no other income source during this period, they will lose their financial capability to support their living expenses if the investment fails. This illustrates that setting a fixed investment entrance alone does not ensure that investors have corresponding risk tolerance and are capable of bearing the consequences of investment failure.

3.2. The Lack of Admission Criteria for Qualified Investors' Investment Experience Makes It Impossible to Ensure Their Risk Identification Ability

In China's legal protection system for private equity investment fund investors, the access criteria for qualified investors are an important issue. According to the relevant regulations, accredited investors need to have more than two years of investment experience, which is to ensure that they have a certain ability to identify risks and provide them with protection. However, there are some problems with this entry standard. First of all, the entry standard lacks the assessment of investors' ability to identify risks. Although investors are required to have more than two years of investment experience, their actual ability to identify risks is not assessed. Some investors may have only gained two years of investment experience by investing in wealth management products or participating in stock trading, but they do not necessarily have strong risk identification capabilities. Such investors may face higher investment risks if they participate in private equity funds, resulting in investment failure [3]. Second, the entry criteria exclude some strong investors who lack investment experience. Some investors may have relatively large amounts of property or income, but do not meet the entry criteria for qualified investors due to lack of investment experience. These investors may participate in investments by creating false investment experiences, which may expose them to investment risks and may interfere with the investment behavior of other accredited investors [4]. In short, although the legal protection system for investors of private equity investment funds in China prevents some investors with insufficient investment experience from participating in investment by stipulating investment experience, it cannot effectively prevent them from entering, so it cannot provide comprehensive protection for investors.

3.3. Lack of Disclosure of Predictive Information Makes it Difficult for Fund Investors to Make Accurate Decisions

For fund investors, they need to take the information provided by the fund manager as a basis in order to make investment information predictions and, accordingly, guide their own investment behavior. However, there are many difficulties for fund investors who wish to conduct information predictions on their own [5]. First, the investment targets of private equity funds are usually unlisted enterprises that have not disclosed much information and have no requirements for public market information disclosure. Therefore, fund investors find it hard to obtain sufficient information, especially predictive information about future development, making it difficult for them to make

investment decisions. Second, fund managers have more information and resources, can conduct in-depth research and analysis, and can make investment decisions based on research results, whereas fund investors do not have access to this information and resources. Nevertheless, fund managers may not want to disclose all information and there may also be situations of information asymmetry, which makes it difficult for fund investors to evaluate the risks and returns of funds. Third, private equity investment funds are a high-risk, high-return investment tool, with high investment risks but also high returns. As fund investors often lack relevant knowledge and experience, it is difficult for them to accurately evaluate risks and returns, and therefore they need more predictive information from fund managers. In addition, China lacks regulations on the disclosure of information by fund managers, and the requirements for information disclosure by fund managers are not strict enough. This often results in a low enthusiasm for fund managers to disclose information, leading to fund investors lacking necessary predictive information, thereby affecting their ability to make accurate decisions.

3.4. The Current Principle of Proof Will Hinder the True Disclosure of Information by Disclosure Obligors

At present, China has not formulated laws and regulations on information disclosure obligors who do not meet the information disclosure requirements [6]. According to the principle of "the parties provide evidence and prove their own claims", if a private equity investor encounters risks because the disclosure obligor fails to disclose the information due diligence, it needs to provide evidence to prove its own view, mainly to prove the existence of a causal relationship between the two, and at the same time to prove that the disclosure obligor is indeed at fault. However, because it is difficult for private equity investors to obtain relevant information, it is extremely difficult for them to provide evidence to prove that the disclosure obligor is at fault. In addition, the difficulty of private equity investors in presenting evidence will make disclosure obligors more inattentive and lax in disclosing information, thereby affecting the protection of private equity investors.

3.5. Lack of Legal Provisions on the Entity for Disclosure of Information on the Transfer of Fund Shares

Although the relevant laws and regulations put forward detailed requirements for information disclosure in some links, mainly for the fundraising and operation links, they do not specifically stipulate the subject of information disclosure obligation for the transfer of fund shares, resulting in unclear information disclosure obligations and difficulty in information disclosure follow-up procedures [7]. Because the subject of the information disclosure obligation is not clear enough, it will be difficult to find the relevant person in charge of the information disclosure obligation, so that no one is responsible for information disclosure and no one bears this responsibility. This situation will lead to a decrease in the investment confidence of potential transferees, and as the number of transferees decreases, it will lead to low price sales, and may not be able to sell.

4. Suggestions on Improving the Legal Protection System for Investors in China's Private Equity Investment Funds

4.1. Set Limits on the Proportion of Asset Investment to Provide Protection for the Living Foundation of Fund Investors

Because the fixed-amount access criteria are flawed and cannot ensure investors' risk-taking, it is necessary not only to regulate investors' income, but also to set limits on the proportion of asset investment, which means that the more investors are allowed to invest in private equity, the more funds they are allowed to invest in private equity. For example, a businessman's income in three years can reach 3 million, which obviously meets the investor access standards and can participate in private equity investment, but after setting the asset investment ratio limit, he can only take part of the 3

million yuan to invest, and other funds are not allowed to invest, so as to prevent him from getting bankrupt because of investing all the income, of course, if the investor's annual income is higher, the higher the amount of his investment will be.

4.2. Set up a System of Investor Entrusted Representatives to Enrich the Investment Experience of Fund Investors

Private equity investors have a lot of money and a certain amount of risk-taking, but they are not allowed to participate because they lack investment experience. In order to prevent these people from using illegal means to participate in investment, we can refer to the foreign "investor representative" system and set up an investor representative system according to the actual situation in China. First, the investor proxy system can help these less experienced investors enrich their investment experience [8]. By entrusting a representative to participate in fund management decisions, fund investors can have a deeper understanding of the relevant knowledge and experience of fund investment, so as to improve the level of investment. When entrusting a representative to handle disputes between fund managers and investors, he can also provide professional legal and investment advice to help fund investors learn and understand relevant knowledge and enrich investment experience. Secondly, in the investment process of private equity investment funds, the entrusted representative can act as a bridge between investors and fund managers, establish good communication channels, and make the relationship between investors and managers more harmonious and stable, which helps fund investors better grasp investment opportunities, improve investment efficiency, and further enrich investment experience.

4.3. Encourage the Disclosure of Forecast Information to Help Fund Investors Make Accurate Decisions

Because fund managers actively disclose information can not only help investors make relevant information predictions, but also help them make more accurate investment decisions, China can add content to encourage the disclosure of forecast information in the relevant private equity fund management regulations, which can not only improve the transparency of fund managers, but also help fund investors make accurate decisions, and help to establish a cooperative relationship and trust foundation between fund managers and fund investors, so as to better promote the investment development of funds [9]. First, fund managers have unique insights and projections about future investments, but this information is often treated as a trade secret and not publicly disclosed. If the fund manager actively discloses some forecast information, it can increase its transparency and help fund investors better understand the investment situation and risks, fund investors often need to evaluate the potential returns and risks of the fund, and the forecast information of fund managers can provide valuable reference. Secondly, if the fund manager actively discloses the forecast information, fund investors can better understand the fund's investment direction and possible return risks, so as to make more accurate decisions, and the disclosure of forecast information can promote trust between fund managers and fund investors. The fund manager's initiative to disclose forecast information indicates its confidence in the fund's investment and future development, and also shows its trust in fund investors.

4.4. Implement Rules for Inversion of the Burden of Proof to Increase the Enthusiasm of Fund Managers to Truthfully Disclose Information

Because the information disclosure obligor’s enthusiasm for information disclosure is not high, our country can learn from the United States’ system of inversion of the burden of proof. If investors suffer economic losses because the information disclosure obligor fails to fulfill the information disclosure obligation, no matter whether the obligor is subjective or mistaken , and regardless of whether it objectively fails to disclose information in an all-round way or provides false information, as long as it cannot provide evidence that can prove that it is not responsible, it needs to bear the corresponding legal responsibility [10]. Implementing the rule of inversion of the burden of proof can

play a role in enhancing the enthusiasm of fund managers for truthful information disclosure. If they fail to truthfully and actively disclose information, they may be investigated for legal responsibility, which can better protect the interests of investors.

4.5. Identify Persons Bound by Disclosure Obligations

For information disclosure, it is very important to determine the subject of disclosure obligations, because it is mainly determined that it can determine the content of disclosure, so China needs to determine the disclosure obligors first when improving the legal protection system for private equity investors. First of all, this can increase the transparency of private equity investment funds, which are more opaque than public funds, and the problem of information asymmetry is more prominent. By clarifying the persons obliged to disclose information, fund managers, fund custodians and other relevant parties can be compelled to disclose more information, so that investors can have a more comprehensive understanding of the investment situation and risks of the fund, and then improve the transparency of the fund. Second, it can attract potential fund share transferees. At present, the investment targets of private equity investment funds are mostly institutional investors and high-net-worth individuals, but with the development of the market, more and more ordinary investors have begun to pay attention to private equity investment funds. Specifying the disclosure obligors can increase investors' trust in the fund, attract more potential fund share transferees, and provide more sources of funds for the development of the fund. In addition, clarifying the disclosure obligors can enhance the effectiveness of supervision. Private equity investment funds are a high-risk, high-yield form of investment and need to be supervised. By clarifying the disclosure obligors, the regulatory authorities can more conveniently supervise fund managers, fund custodians and other relevant parties, so that problems can be discovered and solved in a timely manner and the effectiveness of supervision can be improved.

5. Conclusion

Based on the problem that private equity investors are prone to risks, China has formulated relevant laws and regulations to protect them, but there are many problems in these laws and regulations, such as the lack of investment ratio restrictions, the inability to ensure the risk-bearing capacity of qualified investors, the lack of access standards for investment experience of qualified investors, the inability to ensure their risk identification ability, the current implementation of the principle of proof will hinder the true disclosure of information by disclosure obligors, and the lack of legal provisions on the main body of disclosure obligations for the transfer of fund shares. To this end, China needs to optimize the legal protection system for private equity investors, and by setting restrictions on the proportion of asset investment, providing protection for the living foundation of fund investors, setting up a system of investor entrusted representatives, enriching the investment experience of fund investors, implementing the rule of reversal of the burden of proof, enhancing the enthusiasm of fund managers to truly disclose information, and determining the strategy of disclosure obligors, the protection of private equity investors can be further strengthened, so that their interests can be protected.

References

[1] Zhou Yueying. (2022) Research on legal protection of private equity investors in China. Hebei University of Geosciences.

[2] Fu Xiaoming. (2021) Research on the improvement of investor access system of private equity investment funds in China. Southwest University of Political Science and Law.

[3] Li Yan. (2020) Research on the legal protection of investors of private equity investment funds. Tianjin Polytechnic University.

[4] Qin Jie. (2019) Legal protection of private equity investors. Southwest University of Political Science and Law.

[5] Zhang Bei. (2019) Journal of Beijing Vocational College of Economics and Management, 34 (01), 3 - 9+41.

[6] Qiu Rongfang. (2017) On the improvement of the qualified investor system of private equity investment funds in China. China University of Political Science and Law.

[7] Li Jingchao. (2016) On the protection of investors' rights and interests of private equity funds. East China University of Political Science and Law.

[8] Zhai Kai (2013). On the improvement of the qualified investor system of private equity investment funds in China. Law and Society, 14, 92 - 93.

[9] Li Dan. (2013) China Private Equity Fund Investor Access Legal System Improvement. China Tendering, 11, 30 - 34.

[10] Wang Yan. (2012) Research on the improvement of investor protection system of private equity funds. East China University of Political Science and Law.