



No. 1508 [EN]

IMI Working Paper

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Crowdfunding – Progress, Proposals, and Prospects

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Crowdfunding – Progress, Proposals, and Prospects***

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December 2015

*Published on *University of Cincinnati Law Review*, Vol. 83, No. 2, 2014

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1. Introduction

With the world's second-largest economy at an average of nine percent gross domestic product (GDP) growth rate over the past two decades¹ and a rapidly growing domestic market for new products and services supported by its 1.3 billion population, it is no surprise that China continues to be one of most popular investment destinations for private equity and venture capital firms from all over the world.² Following the worldwide trend of cherishing innovative, internet-based capital-raising and microfinance, crowdfunding³ has emerged as an indispensable approach to enlarge investments to fuel the torpid Chinese capital market.⁴

Since the initiation of crowdfunding in China,⁵ the initiation of crowdfunding and its

¹ See, e.g., *China Economic Update – June 2014*, World Health Org., <http://www.worldbank.org/en/country/china/publication/china-economic-update-june-2014>, (last visited Oct. 15, 2014) (commenting that Chinese economy development has been lagged a bit for the past three fiscal years, however, the growth rate still kept at 7.7% in 2013 and 7.5% for the first half of 2014); see also Xiaodong Zhu, *Understanding China's Growth: Past, Present, and Future*, J. of Econ. Perspectives, Fall 2012, at 103-24, available at <https://www.aeaweb.org/articles.php?doi=10.1257/jep.26.4.103> (discussing China's economic development); *China's Economy: In Three Parts*, The Economist, <http://www.economist.com/news/finance-and-economics/21594999-some-chinese-economic-indicators-are-moving-right-direction-others-are> (last visited Oct. 15, 2014); Wayne M. Morrison, Cong. Research Serv., RL33534, *China's Economic Rise: History, Trends, Challenges, and Implications for the United States* (2013), available at <http://fas.org/sgp/crs/row/RL33534.pdf>; Ettore Dorrucci, Gabor Pula, & Daniel Santabábara, *China's Economic Growth and Rebalancing*, European Central Bank Occasional Paper Series, Feb. 2013, available at <http://www.ecb.europa.eu/pub/pdf/scpops/ecbocp142.pdf>.

² Venture capital investment is a well-accepted while heatedly debated area in China, especially for private companies (minyingqiye). See generally Sonja Cheung, *Venture-Capital Investment in China Is Reviving*, The Wall Street J. (Oct. 30, 2013, 8:02 AM), <http://online.wsj.com/articles/SB10001424052702303618904579167243293611378>; see also EY, *Adapting and Evolving: Global Venture Capital Insights and Trends 2014* (2014), available at [http://www.ey.com/Publication/vwLUAssets/Global_venture_capital_insights_and_trends_2014/\\$FILE/EY_Global_VC_insights_and_trends_report_2014.pdf](http://www.ey.com/Publication/vwLUAssets/Global_venture_capital_insights_and_trends_2014/$FILE/EY_Global_VC_insights_and_trends_report_2014.pdf) (discussing venture capital investment in China); James Yong Wang & Evan Zhang, *Venture Capital Investment in China: Market and Regulatory Overview* (2013), available at <http://www.hankunlaw.com/downloadfile/newsAndInsights/08d1d518df730a313b5ee0960b17ba5f.pdf> (providing a general description on the legal framework for venture capital in China, which counts as a major legal platform for the development of crowdfunding).

³ The conception of “crowdfunding” in China actually mirrors and borrows from the U.S. ideas, i.e., there is no material difference in the nature and format of crowdfunding between China and the rest of world. See, e.g., Joan MacLeod Heminway & Shelden Ryan Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 Tenn. L. Rev. 879, 881 (2011) (discussing that “the concept of crowdfunding finds its root in the broader concept of crowdsourcing, which uses the ‘crowd’ to obtain ideas, feedback and solutions in order to develop corporate activities. In the case of crowdfunding, the objective is to collect money for investment; this is generally done by using social networks, in particular through the Internet (Twitter, Facebook, LinkedIn and different other specialized blogs)”; see also Paul Belleflamme, Thomas Lambert & Armin Schwiendbacher, *Crowdfunding: Tapping the Right Crowd*, 29 J. Bus. Venturing 585, 586–87 (2014); Jeff Howe, *The Rise of Crowdsourcing*, Wired, June 2006, at 176, 178-83, available at <http://www.wired.com/wired/archive/14.06/crowds.html>.

⁴ With over two decades of development, Chinese capital market based on the ups and downs of the stock market is facing quite many problems in terms of regulatory and governance. See Zhiwu Chen, *Capital Markets and Legal Development: The China Case*, 14 China Econ. Rev. 451 (2003) (providing an overview of the Chinese capital market); Nicholas C. Howson, “*Quack Corporate Governance*” as *Traditional Chinese Medicine – The Securities Regulation Cannibalization of China's Corporate Law and a State Regulator's Battle Against Party State Political Economic Power*, 37 Seattle U. L. Rev. 667 (2014).

⁵ See generally The World Bank, *Crowdfunding's Potential for the Developing World 100* (2013), available at http://www.infodev.org/infodev-files/wb_crowdfundingreport-v12.pdf [hereinafter *The 2013 World Bank Report*] (discussing the development of crowdfunding in China, and projecting that “crowdfunding in China could reach \$50

related practices in China have attracted the attention and enthusiasm of Chinese investors across a broad spectrum due to crowdfunding's fundamental advantages over traditional financing vehicles. Through the Internet's convenience, low cost, interactive environment, and efficient exchange of information, crowdfunding has emerged as a way to alleviate the problem of asymmetric information in the Chinese capital market, decentralized the risks that often accompany financial transactions, and established platforms to facilitate private capital investment in terms of "financial disintermediation."⁶

As the global trend moves toward enabling small and medium-sized enterprises to raise funds through Internet platforms or portals, the size of the global crowdfunding industry has soared. In 2012, crowdfunding growth increased to \$17.3 billion from \$3.61 billion in 2009, a fourfold increase in a mere three years. In 2012, crowdfunding platforms raised \$2.7 billion, representing an 81% capital increase and over one million successfully-funded campaigns.⁷ In 2013, crowdfunding reached an estimated \$5.1 billion in capital raised. Further, the number of crowdfunding websites worldwide surpassed 1,500 in 2013.⁸ Initially developed in countries such as the U.S., U.K., and France,⁹ the crowdfunding wave has now spread to the rest of world. The World Bank estimates that in 2025, approximately \$96 billion will be invested in developing countries via crowdfunding, of which \$50 billion of such investments will be accorded to China.¹⁰ The crowdfunding vehicle can directly support small and micro enterprises' direct financing and improve are structuring of the Chinese capital market, which has always been dominated by state-owned banks and large-scale banking institutions.

This article aims to discuss the *status quo* of the development, progress, and issues associated with crowdfunding in China—especially equity crowdfunding, the predominant crowdfunding vehicle. In addition, this article proposes a few viable solutions to the legal issues arising from crowdfunding. This article is not intended to conduct a comparative study in any comprehensive manner of the crowdfunding regimes in China, the U.S., or the U.K. due to space limitations. Four additional parts will discuss crowdfunding in China. Part II briefly summarizes the development and effects of crowdfunding in China and includes a short discussion on fundraising aspects of the Chinese capital market. Part III explains how Chinese securities laws and the criminal code may affect equity crowdfunding, the identification and roles of equity crowdfunding investment contracts, and the rights and obligations of equity

billion by 2025"); see also Daniel Broderick, *Crowdfunding's Untapped Potential in Emerging Markets*, ForbesBrandVoice (Aug. 5, 2014, 10:30 AM), <http://www.forbes.com/sites/hsbc/2014/08/05/crowdfundings-untapped-potential-in-emerging-markets/>.

⁶See Sootoo Institute, Report on the Development of Chinese Internet Crowdfunding for 2014 (2014), available at <http://www.sootoo.com/content/524212.shtml> (last visited Oct. 15, 2014) (in Chinese).

⁷ See Crowdsourcing, Crowdfunding Industry Report: Market Trends, Composition and Crowdfunding Platforms (2012), available at <http://www.crowdfunding.nl/wp-content/uploads/2012/05/92834651-Massolution-abridged-Crowd-Funding-Industry-Report1.pdf>; see also The 2013 World Bank Report, *supra* note 5, at 10.

⁸ See David Drake, Crowdfunding Will Make 2013 The Year of The Gold Rush, Forbes (Dec.27, 2012, 9:03 AM), <http://www.forbes.com/sites/groupthink/2012/12/27/crowdfunding-will-make-2013-the-year-of-the-gold-rush/> (discussing the trend of crowdfunding for 2013 and providing a summary of such development in 2012).

⁹ See Ross S. Weinstein, *Crowdfunding in the U.S. and Abroad: What to Expect When You're Expecting*, 46 Cornell Int'l L.J. 427, 437, 444 (2013) (discussing the development of crowdfunding in U.K., Italy, France and other European countries); see generally The 2013 World Bank Report, *supra* note 5.

¹⁰ See The 2013 World Bank Report, *supra* note 5, at 10.

crowdfunding platforms. Part IV offers a few proposals to resolve the legal issues arising from the operation and sustainable development of equity crowdfunding in China. Part IV further explains how China's securities laws and the criminal code may be amended to accommodate equity crowdfunding and proposes that the rights and obligations of crowdfunding participants need to be clarified. Part V provides a concluding overview.

2. Status Quo of Crowdfunding in China

Since the 2008 financial crisis, the Chinese securities market has been torpid and almost fully abandoned by investors.¹¹ After China initiated crowdfunding as an investment vehicle in 2011, crowdfunding operations developed rapidly, with approximately 120,000 registered investors contributing a total of \$40 million to fundraising for the first half of 2014.¹² China was identified as holding one of the potentially fastest-growing crowdfunding capitals in the next decade. For example, a renowned crowdfunding platform brought online in February 2013 initiated a total of 365 projects with over 60,000 investors and more than RMB 180 million raised capital for just a one-year go-live operation.¹³ An entertainment-focused platform named "Happy Boys' Movie" enlisted nearly 4 million Chinese participants, setting a new record for the number of investors in a single crowdfunding project.¹⁴

In Chinese crowdfunding, an issuer takes the financing functions once performed by traditional banking institutions and transfers those functions to an undefined and generally large network of investors via an open platform.¹⁵ The significant features of Chinese crowdfunding are similar to those in developed regimes. For instance, crowdfunding in China enables Internet technologies such as platform and payment systems and leverages social media. Moreover, Chinese crowdfunding facilitates

¹¹ For a description of volatilities in the Chinese stock market since 2008, see Yan Zhang, *The Stock Prices in China and the Global Financial Crisis* (2013), http://www.aeaweb.org/confer/bus11/papers/Zhang_Yan.pdf. See also Chengsi Zhang, *Financial Crisis, Monetary Policy, and Stock Market Volatility in China*, 12 *Annals of Econ. and Fin.* 371, 371–88 (2011), available at <http://down.aefweb.net/AefArticles/aef120207.pdf>. For a series of discussion on the impacts against China after the global financial crisis in 2008, see generally Richard C. Burdekin, James R. Barth, Frank M. Song & Zhongfei Zhou, *China after the Global Financial Crisis*, *Econ. Res. Int'l* 2011, at 1–3, available at <http://www.hindawi.com/journals/ecri/si/530306/>.

¹² See ZeroIPO Group, *Report on Chinese Crowdfunding Operation Statistical Report for the First Half of 2014* 9 (2014), available at <http://www.zhongchou.cn/deal-show/id-14630> (comparing Sino-US development) (in Chinese).

¹³ See *Crowdfunding Makes Dreams Come True*, EastMoney (Nov. 10, 2014 2:18 PM), <http://finance.eastmoney.com/news/1586,20141110444011916.html> (in Chinese). Zhong Chou Wang (www.zhongchou.cn) is one of the first and largest internet crowdfunding portals in China. "Zhong Chou," or "众筹," is the Chinese translation of "crowdfunding."

¹⁴ "Happy Boys" (kuailenansheng) is a well-known entertainment show that hosts grassroots youth to become celebrities, mirroring the American Idol show. Upon the completion of the 2013 season, the organizer and Zhongchou crowdfunding portal launched a crowdfunding movement to raise funds for a movie designed exclusively for Happy Boys winners. See *How the Happy Boys Movie Fundraising Model Changes the Entertainment Industry*, DoNews (Oct. 18, 2013, 7:38 AM), <http://www.donews.com/media/201310/2617821.shtm>.

¹⁵ See David Mashburn, *The Anti-crowd Pleaser: Fixing the Crowdfund Act's Hidden Risks and Inadequate Remedies*, 63 *Emory L.J.* 127, 139–40 (2013), discussing four advantages of functions that crowdfunding serves for startups over traditional early-stage financing methods, i.e., it helps creating a prelaunch community around its product, tests the market's appetite for a product at an early stage in the commercialization process, it raises capital from any location rather than tying entrepreneurs to traditional "angel investor" and venture capital hotspots, and it critically provides an alternative source of financing that could help plug the capital gap facing startups. See generally Belleflamme et al., *supra* note 3, at 2.

startups as well as small and medium-sized enterprises and avails issuers lack of access to traditional finance. For instance, issuers employ pitch and Q&A sessions to attract investors and complete fundraising within a limited timeframe. Also, portals collect fees or commissions on the funds raised or the profits and require minimum investment.¹⁶ Features of crowdfunding in China also mirrors vehicles such as donation-based crowdfunding by including the following features: typically small amounts per investor are raised to support those in need; pre-payment or rewards-based models are used, where rewards are typically low in value; loan-based peer-to-peer lending is utilized; and investment or bond or equity-based models are used, which is the most significant in terms of the amount of funds raised.¹⁷

Notwithstanding the similarities between Chinese crowdfunding and crowdfunding in other countries, equity crowdfunding constitutes the mainstream crowdfunding practice¹⁸ and will be afforded substantial discussion. Ultimately, any discussion on Chinese equity crowdfunding must consider the contexts of general capital markets in which such a practice is embedded. For instance, almost all of the laws and regulations on securities offerings may affect the operation of equity crowdfunding in China. As long as equity crowdfunding concerns public securities offerings, it will be supervised and administered by the two following Chinese authorities for capital market and banking practice: the China Securities Regulatory Commission (CSRC)¹⁹ and the China Banking Regulatory Commission (CBRC).²⁰ Therefore, we must lay out the background of the Chinese capital market, especially relating to securities offerings.

First, China has made extraordinary efforts in its mission to build-up stable capital markets which took inception back in 1992, when China initiated a so-called socialist market economy. There are over 2,500 listed corporations with a total market capitalization of approximately *Renminbi* (RMB) 4.2 trillion (U.S.\$700 billion) and over 130 million securities trading accounts in both the Shanghai and Shenzhen stock exchanges,²¹ both of which opened around two decades ago. China is expected to be

¹⁶ See Heminway & Hoffman, *supra* note 3, at 890–902, for a general discussion of characteristics of crowdfunding. See also C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 Colum. Bus. L. Rev. 1, summarizing six aspects of crowdfunding websites for exempted offerings according to SEC, i.e., crowdfunding sites would have to (1) be open to the general public; (2) provide public communication portals for investors and potential investors; (3) require investors to fulfill a simple education requirement before investing; (4) prohibit certain conflicts of interest; (5) not offer investment advice or recommendations; and (6) notify the SEC that they are hosting crowdfunding offerings. Sites that meet these requirements would not be treated as brokers or investment advisers.

¹⁷ See Bradford, *supra* note 16, at 14–27 (discussing, in Part II.B, four types of crowdfunding activities).

¹⁸ See *Zero2IPO*, *supra* note 12, at 16–18 (providing that equity based crowdfunding constitutes the mainstream form of crowdfunding in China).

¹⁹ CSRC is a ministerial-level, daily and operative supervisory institution directly performs a unified regulatory function over the securities and futures market of China, maintains an orderly securities and futures market order and ensures a legal operation of the capital market in China. China Sec. Regulatory Comm'n, http://www.csrc.gov.cn/pub/csrc_en/about/ (last visited Oct. 15, 2014).

²⁰ CBRC is one of the highest authoritative institutions managing daily business of Chinese banking institutions. One of the delegated powers engaged by CBRC from the State Council is to authorize the establishment, changes, termination and business scope of the banking institutions, which exactly request crowdfunding platform to comply with in due course. China Banking Regulatory Comm'n, <http://www.cbrc.gov.cn/showyjhhjindex.do> (last visited Oct. 15, 2014).

²¹ See *September 2014 Securities Market Overview Statistics*, CHINA SEC. REGULATORY COMM'N, http://www.csrc.gov.cn/pub/zjhpublish/G00306204/zqscyby/201410/t20141028_262444.htm (last visited Oct. 15, 2014).

one of the largest capital markets in the world by 2020 despite its current sullen performance.²²

One outstanding attribute of the Chinese capital market is the dominance of individual investors and the close attention paid to applicable authorities. Moreover, a large portion of Chinese individual investors do not have a college-level education, a basic investment, or financial skills and knowledge.²³ Thus, individual Chinese investors behave as amateur investors and are likely to invest based on instinct or by following the advice of commentators. Confronted by the critical significance of securing a healthy and stable development of China's capital market and restoring the confidence of investors, Chinese regulatory authorities vigilantly endorse innovative venture financing models such as crowdfunding. For instance, the protection of investors' rights led Chinese securities authorities subsequently to regulate the capital market.²⁴

Second, securities offerings are regulated and interpreted by a wide range of legislation such as securities law, criminal law, contract law and trust law.²⁵ Additionally, the special interpretations of judicial precedent released by the Supreme People's Court of China issues judicial interpretations of the law, and a variety of ministries promulgate and enforce administrative regulations. For instance, equity crowdfunding, as an innovative vehicle for raising capital, faces the dilemma of being governed by cross-ministerial efforts, which are likely to slow decision-making and coordination to reach an executable legal framework.²⁶

Third, the particular profitability mode of crowdfunding complicates relevant regulations because of a lack of fundamental trust among capital participants.²⁷ For instance, most Chinese crowdfunding platforms do not charge fees or commissions for

Data such as the total number of public corporations listed in mainland China and the total market capitalization are available in the Statistical Information (TongjiShuju) section of the CSRC's official website at <http://www.csrc.gov.cn/pub/newsite/sjtj/zqscy/> (in Chinese).

²² According to a Credit-Swiss forecast, the total size of the global capital market will reach approximately US\$284 trillion in 2020 and the Chinese capital market will account for 19% (and the U.S. for 35%). Sam Ro, *CREDIT SUISSE: This Is What The World Stock Market Will Look Like In 2030*, Bus. Insider (Jul. 11, 2014, 9:49 AM), <http://www.businessinsider.com/credit-suisse-global-equity-market-2030-2014-7>.

²³ See generally XIAOQIU WU, *ANNUAL RESEARCH REPORT ON CHINA'S CAPITAL MARKET – CHINA'S CAPITAL MARKET: INSTITUTIONAL CHANGE AND POLICY ADJUSTMENT* (2013); CARL E. WALTER & FRASER J. T. HOWIE, *PRIVATIZING CHINA: THE STOCK MARKETS AND THEIR ROLE IN CORPORATE REFORM* (2003). Both books discuss that the actual numbers of investors in China's stock markets might be smaller than the aggregate numbers of trading accounts opened. Some investors must open separate accounts to trade shares listed in Shenzhen and Shanghai stock exchanges. Moreover, significant problem of multiple accounts being opened and manipulated by institutional and individual investors. WU, *supra* note 23; WALTER & HOWIE, *supra* note 23.

²⁴ See FULIN SHANG, *INDIVIDUAL INVESTOR EDUCATION MANUAL OF CHINESE CAPITAL MARKET* (2009), *excerpt available at* <http://www.sipf.com.cn/touzizheshouce/xuyan.html> (providing that education of individual investor plays a fundamental significance in structuring Chinese capital market, and maturity and knowledge base of investors is a cornerstone of infrastructure of Chinese stock market). Mr. Shang is a former Governor of CSRC.

²⁵ See Part III, *infra*.

²⁶ According to the joint news conference organized and sponsored by the Supreme People's Court of China, the Supreme Procuratorate of China, Ministry of Public Security of China, CBRC and CSRC held in April 2014, crowdfunding as an innovative vehicle of investment is subject to surveillance of illegal fundraising monitoring in terms of openness, profitability, social impacts and legality. See Nick Ring, *CBRC to Issue New Crowdfunding and Illegal Fundraising Rules*, PE Daily (Apr. 22, 2014, 11:15 AM), <http://pe.pedaily.cn/201404/20140422363964.shtml>.

²⁷ See Wu, *supra* note 23, at 22, criticizing that one of the exacerbating factors against informed investment decision is the lack of trust, especially those caused by irresponsible stock reviewers and commentators, quoting Shanghai Securities Daily that none of the forecast provided by an anonymous investment bank was proved correct or accurate.

matching capital-seekers and investors.²⁸ Since Chinese crowdfunding online platforms are in a rudimentary stage of development, the platforms are tasked with establishing the initial trust necessary to stimulate and attract more capital-seekers and investors. Therefore, online crowdfunding platforms have to provide protective terms and conditions for services provided thereon, which will likely add an extra layer of complexity.²⁹ It is unclear whether these existing crowdfunding platforms will eventually receive official acknowledgement as a permitted investment vehicle.³⁰ However, Chinese crowdfunding platforms have quickly gained popularity among investors who do not have the appropriate channels through which to invest. For example, a few successful crowdfunding projects have already been implemented in the field of entertainment and the arts. Therefore, crowdfunding in China faces a two-faced dilemma—obtaining official recognition or hysteric legislation and self-development as incubators with qualified ancillary solutions.

3. Legal Risks Involved in Equity-Based Crowdfunding

Compared to financing models such as direct loans, initial public offerings, or bond issuances, equity-based crowdfunding is still in its embryonic stage.³¹ In China, crowdfunding faces both a great potential for growth as well as an onslaught of substantial barriers in terms of risks generated by the legal framework. On one hand, risks involved therein may help illuminate how crowdfunding may be sustained for long-term development in the current capital market, eventually attaining official accreditation and regulation by CSRC and CBRC. On the other hand, understanding and foreseeing the ramifications, necessities, and mechanisms to incorporate such legal risks are obscure. Moreover, the rules and regulations on innovative investment vehicles, like crowdfunding, are scattered amongst various pieces of legislation as discussed in this article, which are in turn subject to a wide array of statutory objectives, hierarchies, and authorities such as banking, tax, foreign exchange, and securities. Currently, there are no identifiable, unified guidelines on how to delineate the significance and prospects of crowdfunding. Therefore, an analysis of the various risks, especially from a legal perspective, is necessary to clarify an understanding on regulating crowdfunding in China.

In China, the administration of crowdfunding must accommodate national guidelines as well as the interests of industry and local communities. Although certain laws and regulations promulgated by the National People's Congress, the State Council, and the banking administrative apparatus are applicable nationwide, various local banking rulings, notices on securities offerings, corporate governances, and judicial interpretations have given effect to, and defined the content of, these laws in practice. This industry particularism is amplified by local needs to deal with new issues that have not yet been considered by the CSRC, the CBRC, or the People's Bank of China (the Chinese central bank). Local documents on investments or securities

²⁸ See Zero2IPO, *supra* note 12, at 16–18 (discussing a few general aspects of Chinese equity crowdfunding).

²⁹ See Jixiang Hu, *Exploring Localization of Crowdfunding in China*, Sec. Market Herald, Vol. 9 2014, at 4, 9–10, available at <http://wenku.baidu.com/view/ba386f8e0975f46526d3e10a.html> (in Chinese).

³⁰ See Ring, *supra* note 26 (the joint news conference also classifies crowdfunding as a vehicle that is subject to current legislative regime and no specific rulings was designed for crowdfunding).

³¹ See Hu, *supra* note 29, at 10; Belleflamme et al., *supra* note 3, at 32–33; Bradford, *supra* note 16, at 5.

offerings jurisprudentially are “entitled to respect” to the extent that they “have the power to persuade.”

First, not all official documents on securities laws, banking, and the capital market accurately convey the administration’s intent, which is enclosed in the superiors’ order or the instructions.³² Further, local or industry-specific self-interests and discrepancies in understanding may cause inconsistent enforcement of identical legislation. Despite that a nationwide guideline on a specific investment vehicle may be adopted, local administrations may face problems of being understaffed, underpaid, and undervalued. On provincial and municipal levels, the CSRC and the CBRC embody a reverse-triangle hierarchical structure in terms of the number of staff and the enforcement of policies, including crowdfunding. Given that over a thousand rulings, notices, and legislative interpretations encompass the law to be enforced by local or industry administrations, local officials are short on expertise, time, and uniformity in their enforcement of the law. As a result, overly broad discretion and the exercise of high caution by local officials may induce irregular or manipulative assessments of capital market surveillance, which may contribute to adverse enforcement or compliance reviews. In particular, equity-based crowdfunding as an innovative and newly- introduced form of investment in China’s capital market touches at least four major areas of law in its operation and development.

A. Securities Public Offering and Illegal Capital-Raising

A major hurdle for the development of equity-based crowdfunding in China is the strict distinction between public and private offerings. Generally, the definition of a public offering is quite crystallized, but crowdfunding invades the traditional supervisory arena of public offerings by encouraging online private offerings to the general public via an Internet platform.³³

According to Article 10 of PRC Securities Law,³⁴ a public offering must meet substantial conditions and approval procedural requirements prescribed by the State Council and the CSRC; inter alia, without due approval and verifications, “no entity or individual may make a public issuance of any securities.” Moreover, Article 10 stipulates three scenarios which should be categorized as a public offering of securities: (1) securities offerings to unspecific targeted investors,³⁵ (2) public issuance of securities to more than an accumulation of 200 specified investors,³⁶ and (3) public issuance of securities as prescribed by any other law or administrative regulation.³⁷ An offering of

³² Given the Chinese political orientations, usually the decisions adopted by the Communist Party of China during its annual plenary serve as the guidelines for reform in specific industry or sectors of the economy. See, e.g., Xi Jinping, *Explanatory Notes for the 'Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform*, CHINA.ORG (Jan. 16, 2014), http://www.china.org.cn/china/third_plenary_session/2014-01/16/content_31210122.htm.

³³ See *id.* at 29.

³⁴ Zhōnghuá rénguó gòngghéguó zhèngquàn fǎ (中华人民共和国证券法) [Securities Law of the People’s Republic of China] (promulgated by the Standing Comm. Nat’l People’s Cong., Dec. 29, 1998, as amended by the Standing Comm. Nat’l People’s Cong., Oct. 27, 2005, effective Jan. 1, 2006) (2005), available at <http://www.chinalawedu.com/new/23223a23228a2010/20101214shangf14746.shtml> (China).

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.*

securities, which falls into any of these three scenarios, is subject to prior CSRC approval. In addition, Article 10 strictly prohibits any non-public offering of securities from advertising, making public inducements, or utilizing any other public methods to disguise an attempt to solicit investors.³⁸ For instance, CSRC requires strict measures in identifying and policing public offerings of securities without permitting much room for exempted offerings. At first glance, the practices of equity-based crowdfunding in trading or offering securities via an internet platform allow crowdfunding to easily plague the boundaries of the three scenarios of public offering prescribed in Article 10 of PRC Securities Law. However, a vigilant reading of the three scenarios presents numerous issues. First, there is no precise standard on how to categorize an offering solicitee as an “unspecific” targeted investor. Actually, one of the essential attributes of equity-based crowdfunding is investment and financing as a means of dealing securities via an Internet platform. This is similar to securities issuance, but crowdfunding offerings are targeted to unspecific Internet users or investors over the internet. Since equity-based crowdfunding is conducted through an Internet platform, the openness of interaction allows equity-based crowdfunding to, at least initially, interact with unspecific investors.

Interestingly, Chinese criminal law specialists provide a different interpretation of the term unspecific investor. For instance, one proposal held that unspecific means an investor that is either an individual or a group of people who has neither material business nor associations with the issuer.³⁹ However, this interpretation of unspecific investor has been widely discredited. Another proposition provides that unspecific only refers to the initial intention of the issuers to target unspecific investors.⁴⁰ Therefore, this interpretation provides that the underlying business relationship and personal acquiescence should not be accounted for at all. Additionally, the consideration of whether an investor is unspecific does not have any significance as long as the capital-raising is completed within the Chinese capital market context. Given the openness of interaction inherent in Internet platforms, the equity-based crowdfunding offer or must initially solicit investors without identifying the “unspecific-ness” of various investors. Therefore, to avoid issues of anonymity under Article 10 of PRC Securities Law, Chinese crowdfunding platforms are forced to employ alternatives to achieve transferring unspecific investors to certain specific, qualified investors through a series of methods such as real-name authentication and investment-qualification authentication, which are

³⁸ *Id.*

³⁹ See MINGKAI ZHANG, XINGFANZE DE JIESHIYUANLI [PRINCIPLES OF INTERPRETATION OF PRC CRIMINAL LAW] 436–37 (2012), discussing the meaning of “unspecific” might be interpreted as “general public” without any associations with fundraising promoters.

⁴⁰ See generally Jialin Chen & Fengmin Xue, *feifajizifanzuiruoganwentiyANJIU [Research on A Few Issues about Illegal Fundraising]*, J. HENAN U. OF FIN. & POL. SCI., VOL. 25 2013, at 1, available at <http://www.110.com/ziliao/article-484573.html> (quoting Professor Bing Peng that legal fundraising and illegal fundraising should be classified in terms of “sociality” and “openness,” and the purposes of fundraiser should be incorporated in determining whether “unspecific” requirement is fulfilled); see also Wei He & Lufeng Wang, *lunfeifaxishougongzhongcunkuanzui de “gongzhong” de jiedingbiaozhun [The Standards of Classifying “General Public” under the Charge of Illegal Absorbing Pubic Depositions]*, Jurisprudence, Vol.11, 2013 (2013) (arguing how the conception of “general public” may be interpreted as “public” based on certain thresholds of assets and knowledge and the role of “middle- man” or “brokerage”).

partially controlled by various government authorities.⁴¹ However, the practical effect of these methods to reduce anonymity remains uncertain. In summary, the meaning of unspecified remains an open-ended question for regulating equity-based crowdfunding in China.

Second, the ceiling cap on targeted investors may not help the equity-based crowdfunding offeror realize sufficient funds. Under Article 10 of PRC Securities Law, the aggregate number of investors is limited to 200, regardless of whether the investors are specific or unspecified. Therefore, the financing efforts exerted by equity-based crowdfunding raisers may be circumvented by a limited number of financial resources. For instance, the percentage of contribution subscribed by each qualified investor may be limited to a single digit number. For example, Dajiatou (Everybody Invests)⁴² is a major equity-based crowdfunding platform which requires the minimum subscription made by each leading investor and each follow-up investor to be no less than 5%⁴³ and 2.5%⁴⁴ respectively, so as to contain the aggregate number of investors at or within 200. However, controlling the number of investors within the 200-investor cap may not be practical. On the one hand, it is almost impossible for crowdfunding issuers to reasonably predict the number of potential qualified investors; thus, it is virtually impossible to set up boundaries at the outset to confine investor numbers at a targeted amount. On the other hand, even if the aggregate number of qualified investors is managed, any flexibility and freedom of participating in, and withdrawing from, the project are heavily jeopardized. Moreover, given the subscription needs of various investors, most equity-based crowdfunding projects in China must institute technical measures to bar many qualified interested investors from participating in the fundraising. This restriction clearly thralls the fundamental values and initiatives of crowdfunding in terms of synergizing market forces and expanding fundraising sizes and channels.

Therefore, equity-based crowdfunding activities in China must be precisely calculated to avoid violating the relevant requirements stipulated in PRC Securities Law.⁴⁵ However, the success of such calculations is an open question for a variety of reasons. First, the rigor and exactness of the supervision enforced by the CSRC and the CBRC on equity-based crowdfunding are unpredictable. Second, since China's equity-based crowdfunding is still in a very early development stage, any manipulation or scandal displayed in the administration of an issuer may draw heightened attention from the supervisory authorities, resulting in further stringency. Third, it is unclear whether such

⁴¹ See Zhenzeng Xu, *minzhuzhengzhishiyexiadewangluoshimingzhi-jiyudangqianwangluohoutaishimingzhuceguanlizhidu de zaisikao* [A Reconsideration of Internet Real Name Authentication from the Democracy and Political Perspectives], *HEBEI LAW SCI.*, Vol. 9 2012, at (2012), available at http://d.g.wanfangdata.com.cn/Periodical_hbfx201209025.aspx (discussing the pros and cons of the real name authentication system in China and concluding the immaturity in implementing such a regulatory scheme).

⁴² For detailed information on proposed projects and investors' terms, see Dajiatou, <http://www.dajiatou.com/> (last visited Oct. 15, 2014).

⁴³ See He Zhiyang, *lingtounenzuiditouziedushixiangmurongzie'de 5%* [Leading Investors Must Subscribe No Less Than 5% of the Total Crowdfunding Capitalization], *SZ ONLINE* (Jun. 24, 2014), <http://it.szonline.net/458102/264768663422b.shtml>.

⁴⁴ The 2.5% minimum subscription requirement is marketed as one of the key advantages of Dajiatou portal. See *Guānyú wǒmen* (关于我们) [About us], *DAJIATOU*, <http://www.dajiatou.com/list-2-1.html> (last visited Oct. 15, 2014).

⁴⁵ See Hu, *supra* note 29, at 10.

calculations might be reliable enough to continue to attract and keep investors subscribing and trading securities offered through the crowdfunding platform. Finally, given the lack of respect to the spirit of freedom to contract⁴⁶ and the notorious volatility of the Chinese capital market, such calculations may cause further turbulence thereof.

Another alternative to regulating equity-based crowdfunding is categorizing it as a form of “illegal fundraising,” which is ordinarily policed by the PRC Criminal Law and relevant judicial interpretations. However, there is no specific cause of action of illegal fundraising in the PRC Criminal Law.⁴⁷ Instead, illegal fundraising is implicitly covered by at least three different categories of crimes: fraudulent issuance of shares and company bonds; absorbing public deposits illegally; and unapproved issuance of shares, corporate, or enterprise bonds.

Under § 3 of Offenses Against Company and Enterprise Management Order, Article 160⁴⁸ stipulates that the fraudulent issuance of securities and corporate bonds is prohibited. In particular, the concealment of material facts or the fabrication of major fraudulent contents in share-soliciting prospectuses, share-subscription applications, and bond solicitation by companies and enterprises for the purpose of issuing shares or bonds in a company or enterprise shall be punished with imprisonment along with a fine or a separately imposed fine of a certain percentage of the illegally-raised capital. Moreover, if a corporation commits the same or similar offenses, it shall be punished with a fine, and the personnel directly in charge shall be punished with imprisonment.

Under § 4 of Crimes of Undermining the Order of Financial Management, Article 176⁴⁹ stipulates that illegally absorbing deposits from investors is prohibited. In particular, any taking of deposits illegally or in a disguised form which disrupts the financial order shall be sentenced and fined, additionally or exclusively, depending on the gravity of the illegal conduct or the amounts involved. Moreover, if a company commits the same or similar offenses, the individual directly in charge and those directly responsible shall be punished in due course.

Also, under § 4 of Crimes of Undermining the Order of Financial Management, Article 179⁵⁰ stipulates that any unapproved issuance of shares or company bonds is strictly prohibited. In particular, any unauthorized issuance of shares or company and

⁴⁶ See generally Simon Whittaker, *The Optimal Instrument of European Contract Law and Freedom of Contract*, 7 EUR. REV. OF CONT. L. 371 (2011) (providing that freedom of contract can be seen as an economic principle on which markets of all kinds are to be based and be seen as a moral principle according to which the justification for contractual obligations is found in the choice (or will) of the individual parties to the contract. This principal is typically expressed as “contractual autonomy” or “the autonomy of the will,” with obvious roots in the philosophies of Rousseau and Kant). See also Scott R. Peppet, *Freedom of Contract in an Augmented Reality: The Case of Consumer Contracts*, 59 UCLA L. Rev. 67 (2012) (providing that the meaning of “freedom of contract” may have different meanings, and our increasingly “augmented reality” calls into question leading justifications for distrusting consumer contracts and strengthens traditional understandings of freedom of contract).

⁴⁷ Zhōnghuá réngōng héngfǎ (中华人民共和国刑法) [People’s Republic of China Criminal Law] (promulgated by the Standing Comm. Nat’l People’s Cong., Jul. 1, 1979, as amended by the Standing Comm. Nat’l People’s Cong., Mar. 14, 1997, effective Oct. 1, 1997) (1997), available at [⁴⁸ See *id.* § 3 art. 160.](http://www.npc.gov.cn/huiyi/lfzt/xfxza8/2008-08/21/conteZhōnghuá réngōng héngfǎ (中华人民共和国刑法) [People’s Republic of China Criminal Law] (promulgated by the Standing Comm. Nat’l People’s Cong., Jul. 1, 1979, as amended by the Standing Comm. Nat’l People’s Cong., Mar. 14, 1997, effective Oct. 1, 1997) (1997), available at http://www.npc.gov.cn/huiyi/lfzt/xfxza8/2008-08/21/content_1588538.htm (China).nt_1588538.htm (China).</p></div><div data-bbox=)

⁴⁹ See *id.* § 4 art. 176.

⁵⁰ See *id.* § 4 art. 179.

enterprise bonds which involve a substantial amount of money shall be sentenced and fined, additionally or exclusively, in the amount of a certain percentage of the illegally raised funds. Moreover, if a company commits same or similar offenses, the individual directly in charge and those directly responsible shall be punished in due course.

Moreover, given the overheated private lending and fundraising activities conducted after the 2008 financial crisis, the Supreme People's Court of China issued "the Interpretation of the Supreme People's Court of Several Issues on the Specific Application of Law in the Handling of Criminal Cases about Illegal Fund-raising" (Interpretation),⁵¹ which established practical and detailed rulings on illegal fundraising in earnest. Article 6 of the Interpretation confirms that any individual or entity which, without the approval of the relevant competent department of the state, issues to a specified 200 persons or more accumulatively any of the following shall be deemed to have met the condition of "issuing shares or corporate or enterprise bonds without authorization" as prescribed by Article 179 of the Criminal Law: (1) shares, corporate bonds, or enterprise bonds to unspecified people, or does so in a disguised form such as transferring equities;⁵² or (2) shares, corporate bonds, or enterprise bonds or does so in disguised form.⁵³ "If any crime is constituted, the offender shall be convicted of and punished for the crime of issuing shares or corporate or enterprise bonds without approval." Although the Interpretation clarifies the charges related to unapproved securities and corporation bond issuances, it remains unclear how the Supreme People's Court would identify the meaning and scope of the terms unspecified and issuance in disguised form.⁵⁴ This allows the judicial practice more flexibility (yet creates uncertainties) in reviewing relevant cases. For instance, equity-based crowdfunding is very likely to be interpreted as a vehicle of securities issuance and thus subject to the governance of the Interpretation and Article 179 of the PRC Criminal Law. Moreover, according to the judicial proceeding of "first the punishment queen people" in China,⁵⁵ if equity-based crowdfunding does not operate very cautiously to avoid the limitations on unspecified investors and the ceiling cap of 200 targeted investors, crowdfunding investments will likely be prohibited or confiscated, inducing unforeseen losses for investors and continuing the obscurity of qualifications for operating a crowdfunding platform.⁵⁶

B. Fraud in Investment Contract

In essence, equity-based crowdfunding is an innominate contract for investment purposes. The investor and the issuer ordinarily execute the agreement, while the crowdfunding platform acts as an intermediary to facilitate the agreement. Generally, in

⁵¹ MINISTRY OF PUB. SEC. OF CHINA, (Jan. 6, 2011), <http://www.mps.gov.cn/n16/n1282/n3493/n3838/2921956.html>. This judicial interpretation usually is used as authoritative guidelines for lower courts to adjudicate relevant fundraising disputes and cases.

⁵² *See id.*

⁵³ *See id.*

⁵⁴ *See id.*

⁵⁵ *See generally* JingxianCai, *budang deli jufenzhongxianxinghouminyuanze de chuli* [The Application of Principle of First the Punishment Queen People in Unjustified Enrichment Cases], PEOPLE'S JUSTICE, Vol. 22 2012, at 71 (discussing that the principle of First the Punishment Queen People refers to firstly prosecuting suspects with criminal charges then seeking civil damages for plaintiffs or victims).

⁵⁶ *See id.*; *see also* Ring, *supra* note 26 (the joint conference also implicitly mentioned that the ceiling number of 200 investors is strictly enforced).

China, equity-based crowdfunding capital-seekers rely on the strength of experienced, leading investors to advise “follow-up” investors in locating investment projects.⁵⁷ Leading investors are usually professionals with rich experience in private offerings and label themselves as holding innovative techniques in investment strategies and possessing sound insights.⁵⁸ On the contrary, follow-up investors usually do not have even basic financial skills, but they do ordinarily control certain financial resources for investment. When a leading investor selects a target investment project through an equity-based crowdfunding platform, the leading investor usually invests personal funds into the project. Crowdfunding capital-seekers then take advantage of the leading investor’s funds to market the project to follow-up investors. Clearly, this mechanism will magnetize non-professional investors with laid-up capital and investment willingness.

However, issues arise from this “leading plus following-up” model for equity crowdfunding in China. First, this recommendation-guided investment approach distorts the congenial mentality of follow-up investors, who collectively may be less-mediated in investment decision-making, leading to a high possibility of fraud or manipulation through an investment contract. It is quite common for follow-up investors to be completely blind of any relationships, whether commercial or fraudulent, between the issuer and the leading investors.⁵⁹ Second, given the asymmetry of information on crowdfunding projects between leading investors, issuers, and follow-up investors, such as investment details, the terms and conditions of a standard crowdfunding investment contract form may be disadvantageous for follow-up investors, who may not have access to legal advice or possess a sophisticated financial background.⁶⁰ Very possibly, if crowdfunding projects fail to realize expected profit levels, follow-up investors may attribute any failure to, and seek damages from, the crowdfunding platforms. This is detrimental to the long-term development of crowdfunding in China, especially if there is certain collusion between the leading investors and the issuers. Third, the remedies available for fraudulent crowdfunding are limited for follow-up investors. Based on the leading investor’s established reputation and large number of existing followers, the leading investor’s decisions to finance a specific crowdfunding project are likely to cause “herd behavior.”⁶¹ Herd behavior results in follow-up investors, who

⁵⁷ The crowdfunding model of “leading investor plus follower” has been criticized by many commentators, see *guquanzhongchou – lingtou + gentoumoshi de biduan* (股权众筹：领投+跟投模式的弊端) [*Crowdfunding – The Disadvantages of Leading + Following*], CHINA ELEC. COMMERCE RESEARCH CTR. (Nov. 7, 2014 9:58 AM), <http://b2b.toocle.com/detail--6209198.html>, quoting the discussion of legal risks involved in equity crowdfunding commented by Qunlin Li, CEO and Chairman of “Dajiatou”, that leading investors usually are more familiar with the projects and would endorse the crowdfunding project, but the reviewing process is conducted by the crowdfunding portal itself.

⁵⁸ *See id.*

⁵⁹ *See id.* The crowdfunding portal has to design an intermediary platform to keep the investing funds until the last minute thus to avoid any cheating by leading investors, which creates an additional layer of review and the effect of such intermediary platform is open to question.

⁶⁰ *See Xiaorui Xu, zhongchouzhongdexinxibuduichenwentianjiu* [*Research on Crowdfunding Related Asymmetry of Information*], CHINA ELEC. COMMERCE RESEARCH CTR. (Sep. 9, 2014 11:18 AM), <http://b2b.toocle.com/detail--6194629.html> (discussing generally the characteristics of asymmetry of information as to crowdfunding in China).

⁶¹ *See David S. Scharfstein & Jeremy C. Stein, Herd Behavior and Investment*, 80 AM. ECON. REV. 465, 466 (1990), available at http://www.people.hbs.edu/dscharfstein/articles/herd_behavior_and_investment.pdf, employing a “learning” model that investors just mimic the investment decisions ignoring substantive private information, which is manipulated by major players in certain market.

may be unaware of the investment risks, to follow blindly the investment decisions of the leading investors. If an issuer commits fraudulent crowdfunding after acquiring the target amount of funds through crowdfunding, the follow-up investor may have no remedy to seek damages so long as traditional class-action litigation remains unpopular in China.⁶² Even if a few follow-up investors were able to bring a lawsuit against the issuers for damages, the litigation costs and the procedure may prove to be too burdensome.⁶³

The risks of fraud in crowdfunding investment contracts cannot be underestimated due to China's undeveloped legal environment with regards to remedies and undeveloped capital market practices.⁶⁴ Damages caused by an asymmetry of information among crowdfunding platform, issuers, leading investors, and follow-up investors demand a fully channeled regulatory mechanism.⁶⁵ Moreover, the detriments of information asymmetry may be further exacerbated by herd behavior of follow-up investors.

C. The Ambiguous Identification and Function of Crowdfunding Platforms

Equity-based crowdfunding generally plays a mixed role of matchmaking the investment needs of investors and issuers while implementing fees to publish the project and facilitate performance of the investment contract in order to realize profit.⁶⁶ Additionally, the services provided by Chinese equity-based crowdfunding platforms exceed the traditional scope of brokerage services in China.⁶⁷ Further, service contracts executed between investors and crowdfunding platforms do not comport with typical brokerage contracts.⁶⁸ Specifically, various service agreements executed between an equity-based crowdfunding platform, the issuers, and the investors allow the crowdfunding platform to focus primarily on managing the investments attached to its intermediary role.⁶⁹ Similar to major international crowdfunding platforms, a few

⁶² See generally ZHU Yan & Pan Weilin, *Focus: Punitive Damages in China: A Study of Punitive Damages in China*, *Frontiers of Law in China*, Volume 9 No. 3, (2014), (discussing most recent updates in Consumer Protection Law, origins, background, evolution and development of punitive damages on contract breaches regarding services and commodity in China), available at <http://www.law.ruc.edu.cn/uploadfile/20149/201492914394573499.pdf>. See also Yaoyuan Han & Qiaobin Wu, *liqing rending fenqijixibadanandian [Clarifying Classification Confusions and Analyzing Eight Issues]*, CHINA PROSECUTION DAILY, May 12, 2014, at 3, available at http://newspaper.jcrb.com/html/2014-05/12/content_158763.htm. The authors, two senior analysts from the Supreme People's Court of China, argue that damages sought after convicting illegal fundraisers should be handled separately from the irrelevant assets owned by the illegal fundraisers, i.e., the damage should be adjudicated solely on the basis of illegal funds raised. *Id.*

⁶³ See *id.*

⁶⁴ See WU, *supra* note 23, at 33–35, exploring major problems existing in Chinese capital market. According to Professor Wu, the twisted guidelines in structuring the capital market is a prioritized issue to be resolved, especially on the function of capital market within the big picture of Chinese economic development. *Id.* The volatility of reforming process of Chinese capital market process clearly reflects leaderships' underestimation of social impact of capital market.

⁶⁵ See *id.*, at 23 (discussing a few recent cases on illegal fundraising which are exclusively caused by asymmetry of information between leading investors (sometimes fundraisers themselves) and follow-up investors).

⁶⁶ See Bradford, *supra* note 16, at 60 (discussing that the crowdfunding portal is a platform for investors and entrepreneurs to negotiate, facilitates ongoing communications between investors and entrepreneurs; transmits funds and investment documents back and forth between investors and entrepreneurs).

⁶⁷ *Id.* See also generally ZHU Jingwen, *Data Analysis of Professionalization of Legal Workers in China*, Volume 9, No. 2, *Frontiers of Law in China* (2014) (discussing the availability and development of Chinese legal professionals and practitioners to citizens), available at <http://www.law.ruc.edu.cn/uploadfile/20147/201471111535873499.pdf>.

⁶⁸ See *id.* (providing a general template for a brokerage contract).

⁶⁹ See, e.g., *Yònghìzhìcǎifúwùxiéyì* (用户注册服务协议) [*User Registration Service Agreement*], ZHONG CHOU WANG, <http://www.zhongchou.cn/help-registerpro> (last visited Oct. 15, 2014) (providing a template user service

notable Chinese equity crowdfunding platforms require investors to comply with a standard service contract upon registration of an investment account. For example, AngelCrunch, a leading equity crowdfunding platform, outlines situations in which AngelCrunch may unilaterally terminate services, deregister the investor's account, shutdown technical support, or report illegal activities to the authorities.⁷⁰ AngelCrunch provides that these situations include, but are not limited to, infringing a third party's intellectual property rights,⁷¹ orchestrating the crowdfunding platform to conduct crimes or prohibited activities,⁷² disseminating rumors or unfounded information to distort capital,⁷³ using fraudulent or falsified information to maliciously induce investment,⁷⁴ etc. Through such terms in a service contract, equity crowdfunding platforms can play an expanded role in managing investors rather than facilitating investments.

Such terms and conditions in service contracts are very common in developed legal regimes such as the U.S.⁷⁵ and Europe.⁷⁶ Despite China's lack of freedom to contract and turmoil in the capital markets, such terms are still quite standard and acceptable by Chinese investors.⁷⁷ There is a concern that such a standard form will give crowdfunding platforms too much discretion to manipulate the equity enjoyed by investors.⁷⁸ For example, Article 16.2 of the AngelCrunch service agreement⁷⁹ stipulates that any revisions or updates made by AngelCrunch of the terms in the service contract will be deemed automatically accepted by an investor, so long as the user maintains an active subscription to the platform.⁸⁰ Moreover, Article 16.2 stipulates that, unless agreed to by AngelCrunch in advance, any revisions made to the service agreement by an investor or capital-seeker will not be accepted.⁸¹ If an investor or issuer makes revisions without the prior approval of AngelCrunch, the investor or capital-seeker must cease to participate in all investment projects through the platform.⁸²

In addition, PRC Contract Law governs crowdfunding service contracts⁸³ in terms of designating the relevant rights and obligations of the contracting parties. If the terms

agreement); *Yònghì fúwù yì yì* (用户服务协议) [*User Services Agreement*], ANGELCRUNCH, <http://help.angelcrunch.com/service> (last visited Oct. 15, 2014).

⁷⁰ See ANGELCRUNCH, *supra* note 69, at art. 5 (article 5 specifically stipulates various scenarios that it may interfere with investors' decisions in due course).

⁷¹ See *id.*

⁷² See *id.*

⁷³ See *id.*

⁷⁴ See *id.*

⁷⁵ See, e.g., *Terms of Use*, KICKSTARTER, <https://www.kickstarter.com/terms-of-use> (last visited Oct. 15, 2015).

⁷⁶ See, e.g., *Terms and Conditions*, FUNDING CIRCLE, <https://www.fundingcircle.com/home/terms-and-conditions> (last visited Oct. 15, 2014).

⁷⁷ See Hu, *supra* note 29, at 10, noting that crowdfunding investors in China only have a very limited portals available to choose and such imbalanced demand-supply relationship forces investors to accept, sometimes unwillingly, such terms and conditions.

⁷⁸ See generally Hui Lu, *Zhōngguó shì gǔquánzhòngchāo de tóuzīzhěfēngxiǎn* (中国式股权众筹的投资者风险) [*Risks Faced by Equity Crowdfunding Investors of Chinese Characteristics*], XUEQIU, <http://xueqiu.com/3516695940/30216966> (last visited Oct. 15, 2014) (discussing three aspects of risks: project risks, crowdfunding risks, and operational risks relating to portals).

⁷⁹ See ANGELCRUNCH, *supra* note 69, at art. 16.

⁸⁰ See *id.*

⁸¹ See *id.*

⁸² See *id.*

⁸³ *Zhōnghuá rénmín gòng héng hé tóng fǎ* (中华人民共和国合同法) [*Contract Law*] (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 15, 1999, effective July 1, 1999), available at <http://www.falvguwen.info/908w9.html> (China).

and conditions of a contract are too one-sided, such terms may be held invalid or unenforceable. Under Article 77 of PRC Contract Law,⁸⁴ a contract may be modified if the parties reach an agreement through mutual negotiation, which carries out the spirit of equity. However, if a Chinese crowdfunding contract is executed with terms similar to, for example, AngelCrunch's service agreement, those one-sided terms are likely to be voided by the courts for insufficiently protecting investors. Moreover, terms like those in Article 5.3 of the AngelCrunch service contract,⁸⁵ which claim the platform is not responsible for any damages arising from an interruption of Internet or telecommunication services, technical malfunctions, computerized errors or viruses, or loss of user information will likely be stricken by courts for insufficiently protecting follow-up investors who may invest substantial funds in crowdfunding.⁸⁶

In China, it is still unclear whether the equity crowdfunding platform serves as (1) a sole intermediary for connecting issuers and investors⁸⁷ or (2) a quasi-regulating broker to manage the process associated with the investment.⁸⁸ In fact, numerous leading investors may have complicated such contracts by venturing their capital in the establishment of the crowdfunding platforms. Therefore, the relationships among crowdfunding investors, crowdfunding platform, issuers, and platform investors must be clarified and accurately identified. Unfortunately, there have not been any supervisory regulations in this area of investment, and such vacancy in legislation and administration will continue to leave investors unprotected and expose equity to risk.

4. Proposals for Reforming Equity Crowdfunding Development

A great deal of uncertainties must be clarified regarding what form legal equity crowdfunding should take and what aspects of crowdfunding should be regulated in China. As crowdfunding is still a new investment vehicle in China, it is unclear how authorities will view equity crowdfunding as a practical means of raising capital and incentivizing the growth of small-scale businesses. The regulation scheme should consider the overall development of the Chinese capital market, within which equity crowdfunding will be embedded. For instance, the equity crowdfunding experience abroad,⁸⁹ where it is either legally regulated or tolerated, serves as an instructive model of the kinds of legal and extralegal tools that may be employed to effectively regulate equity crowdfunding. For example, the U.S., via its JOBS Act,⁹⁰ the U.K.,⁹¹ and

⁸⁴ *See id.*

⁸⁵ *See* ANGELCRUNCH, *supra* note 69, at art. 16.

⁸⁶ *See* Yuting Yang, *qianlunhetong de danfangjiechuquan* (浅论合同的单方解除权) [A Brief Research on the Right to Rescind the Contract Unilaterally], FAZHIYUSHEHUI (法制与社会) [Rule by L. & Soc.], Vol. 25 2013, at 16 (discussing several scenarios that one party of a contract may unilaterally terminate the contract and obtain judicial support from the court), available at <http://www.cnki.com.cn/Article/CJFDTotal-FZSL201325009.htm>.

⁸⁷ *See* Hu, *supra* note 29, at 10 (discussing the complexities and confusion on roles played by Chinese crowdfunding sites).

⁸⁸ *See id.*

⁸⁹ *See* Weinstein *supra* note 9, at 428–29.

⁹⁰ *See generally* Joan M. Heminway, *The New Intermediary of The Block: Funding Portals Under the CROWDFUND Act*, 13 U.C. DAVIS BUS. L.J. 177 (2013) (discussing the pros and cons of funding portals); *see also* Bradford, *supra* note 16, at 117 (discussing the considerations for structuring proposals for exempting crowdfunding activities from federal securities laws).

⁹¹ *See* Weinstein *supra* note 9, at 437 (discussing legislative development on crowdfunding in U.K.).

France⁹² have begun to provide regulation strategies that may standardize equity funding as the practice matures.

Discussions of the experiences of regulating equity crowdfunding are voluminous.⁹³ A preliminary examination of those discussions reveals a several issues, including: (1) the purposes of supervision and regulation, (2) limitations imposed on crowdfunding investors, (3) clear delineations of rights and obligations of capital-seekers and the crowdfunding platform, and (4) the protections of crowdfunding investors. Chinese regulations regarding equity crowdfunding need to prioritize and resolve the following three major issues.

First, the specific cultural, social, political, and legal roots as well as the development of the Chinese capital market should be factored in the regulatory framework of equity crowdfunding. Otherwise, Chinese regulations on equity crowdfunding may easily become descriptive, mechanical, and perfunctory elements with tenuous practical value or legislative significance.⁹⁴

Second, regulations of crowdfunding in China should prioritize protecting investors' rights by offering more flexibility for share transfer and trading. The overall regulatory scheme on crowdfunding must nonetheless conduct a comparative study to the Chinese context.⁹⁵ Within an operational framework, a cohort of fund investors is the least advantageous group out of all the parties involved in crowdfunding activities. Meanwhile, other than encouraging healthy development for the capital market, Chinese authorities emphasize investors' rights, which represent one of the defining cornerstones of the market.⁹⁶ The unfavorable position of investors in terms of asymmetric information makes legally remedying the imbalance between investors and capital-seekers a great necessity in order to realize the unprejudiced equity of contracting parties.

Third, the regulatory framework on Chinese crowdfunding must be taken piecemeal rather than through a general overhaul of the current system.⁹⁷ Even though crowdfunding regulations are mostly debated and interpreted in predominantly Western terms like progress, equity, and efficiency,⁹⁸ all crowdfunding regulations should respect the *status quo* of the Chinese securities law.⁹⁹ Any eagerness for quick success and instant benefits may endanger the long-term development of crowdfunding in China. Tailored, innovative approaches are likely necessary given China's strict regulations on securities offerings. Such measures to regulate crowdfunding should account for both the valuable transplantation of proved foreign experiences and

⁹² See *id.*, at 444 (discussing legislative development on crowdfunding in France).

⁹³ See generally, Bradford, *supra* note 16; Weinstein, *supra* note 9.

⁹⁴ See generally Hu, *supra* note 29, at 5.

⁹⁵ See Omri Y. Marian, *The Discursive Failure in Comparative Tax Law*, 58 AM. J. COMP. L. 415 (2010) (discussing that a comparative method should be adopted in learning different regimes, such as taxation law).

⁹⁶ See generally SHANG, *supra* note 24.

⁹⁷ See Jacques deLisle, *Lex Americana?: United States Legal Assistance, American Legal Models, and Legal Change in the Post-Communist World and Beyond*, 20 U. PA. J. INT'L L. 179 (2014) (discussing how the piecemeal approach may be adopted in reforming Chinese legal system in terms of achieving both social and legal significance); see Tom Ginsburg, *Does Law Matter for Economic Development? Evidence from East Asia*, 34 L. & SOC'Y REV. 829, 846 (2000), available at <http://home.uchicago.edu/~tginsburg/pdf/articles/DoesLawMatterForEconomicDevelopment.pdf> (discussing that soviet transplants in improving on the piecemeal and experimental approach to legal reform characterized the early years of the Deng Xiaoping era in economic reform).

⁹⁸ See generally Joan M. Heminway, *What is a Security in the Crowdfunding Era?*, 7 Entrepren. Bus. L.J. 335 (2012).

⁹⁹ See Part II, *supra*.

improving the efficiency of Chinese crowdfunding practices.¹⁰⁰ For instance, the following proposals should be fully contemplated to promote equity crowdfunding in China: (1) reevaluate illegal fundraising in PRC criminal law, (2) amend certain provisions on securities public offerings, (3) refine the classification and investment authority of investors, and (4) clarify the identity and function of the equity crowdfunding platform.

A. Reevaluate Illegal Fundraising in PRC Criminal Law

Since 2013, the Chinese government has embarked on a wave of anti-illegal fundraising campaigns, attempting to clearly lay out the applicable regulations.¹⁰¹ In 2008, the Inter-ministry Anti-Illegal Fundraising Task Force was established.¹⁰² Further, the Supreme People's Court announced that illegal fundraising would be treated as a criminal cause of action, which furthered the efforts made by the Task Force to regulate illegal fundraising.¹⁰³ In China, illegal fundraising's roots trace back to the rise of private enterprise in the 1990s. Given the constrained disposition of the banking system, which continues to lend exclusively to large and state-owned corporations,¹⁰⁴ small-sized enterprises and individuals are forced to venture outside official banks and credit unions for funding. Therefore, the great majority of fundraising activity for small, private enterprises has been for highly-productive purposes, such as working capital; relatively little fundraising activity has defrauded public investors.

In particular, equity crowdfunding has been a cause for concern in terms of exploiting loopholes contained in illegal fundraising supervision and administration. For instance, the PRC Criminal Law has not expressly held that illegal fundraising is a crime.¹⁰⁵ Instead, PRC Criminal Law implicitly outlines three possible scenarios (Articles 160, 176, and 190) that may or may not apply to illegal fundraising.¹⁰⁶ Since PRC Criminal Law does not expressly apply to illegal fundraising, but may so apply implicitly, there is uncertainty regarding how to develop equity crowdfunding because of potential liability. As equity crowdfunding continues to gain popularity as a vehicle

¹⁰⁰ See deLisle, *supra* note 97, at 183, discussing how recipient-country context extends U.S. legal aid and exports U.S. legal models, which may lead to various impacts of such efforts.

¹⁰¹ See generally Sara Hsu, *China's Ongoing Battle with Illegal Funding*, THE DIPLOMAT (Apr. 28, 2014), <http://thediplomat.com/2014/04/chinas-ongoing-battle-with-illegal-fundraising/> (discussing Chinese governmental cross-ministerial efforts in fighting with illegal fundraising); see also *When Fundraising Is A Crime*, THE ECONOMIST (Apr. 14, 2011 10:51 AM), <http://www.economist.com/node/18560729> (discussing the details of the famous Wu Ying illegal fundraising case in Zhejiang Province, China).

¹⁰² See Hsu, *supra* note 101.

¹⁰³ See generally Zuìgāorénmínfǎyuàn, zuìgāorénmínjiǎncháyuàn, gōng'ānbùguānyúbànlfěifājizixingshiànjiànshiyòngfǎlùduōgānwénti de yìjiàn (最高人民法院、最高人民检察院、公安部关于办理非法集资刑事案件适用法律若干问题的意见) [Opinions of the Supreme People's Court, the Supreme People's Procuratorate and the Ministry of Public Security on Several Issues concerning the Application of Law in the Handling of Illegal Fund-raising Criminal Cases] (promulgated by the Supreme People's Court, Supreme People's Procuratorate, & Ministry of Public Security, Mar. 25, 2014, effective Mar. 25, 2014), <http://lawinfochina.com/display.aspx?id=17103&lib=law&SearchKeyword=&SearchCKeyword=> (China) (discussing guidelines in regulating illegal fundraising cases).

¹⁰⁴ See Hsu, *supra* note 101.

¹⁰⁵ See Part III, *supra*.

¹⁰⁶ See ZHANG, *supra* note 39.

of Internet financing in China, along with pressures to monitor shadow banking¹⁰⁷ and peer-to-peer lending,¹⁰⁸ it is necessary to reassess the feasibility of imposing or expressly defining illegal fundraising as a separate crime. Further, the reevaluation of illegal fundraising as a crime is necessary to clarify the current status of crowdfunding and other online fundraising activities so as to accommodate the rapid changes of the economic and investment settings in China.¹⁰⁹ In this regard, the following issues should be clarified in the regulation of illegal fundraising activities in earnest: (1) the categorization and boundaries of what constitutes legal fundraising; (2) the practicality of enforcing illegal fundraising; and (3) the legislative intent regarding the applicability of PRC Criminal Law to illegal fundraising.¹¹⁰

Firstly, the categorization and boundaries of what constitutes legal fundraising is still obscure. Therefore, the definition of legal fundraising must be refined, especially since the number of issuers without a lending license continues to increase. Currently, illegal fundraising is understood to be the act of collecting funds from the general public for personal, financial purposes.¹¹¹ In an effort to provide such guidance on illegal fundraising, the Supreme People's Court has classified the thirteen most common types of fraudulent projects, including using funds to sell commodities, holding rural "Investment Fairs," and borrowing at high interest rates for the purported purpose of building supermarkets. Although these types of fraudulent projects are widely varied, there is one thing they all hold in common: condemning false marketing or advertising for nonexistent projects or exaggerated profits, which may be punished by death in certain circumstances, however, such punishment is expected to be removed from the criminal law.¹¹² Therefore, there is no definite boundary of what constitutes legal

¹⁰⁷ See Jianjun Li & Sara Hsu, *Shadow Banking in China: Institutional Risks 1* (Pol. Econ. Research Inst., Working Paper No. 334, 2013), available at http://www.peri.umass.edu/fileadmin/pdf/working_papers/working_papers_301-350/WP334.pdf; see Nico Valckx, et al., *Shadow Banking Around the Globe: How Large, and How Risky?*, in GLOBAL FINANCIAL STABILITY REPORT: RISK TAKING, LIQUIDITY, AND SHADOW BANKING – CURBING EXCESS WHILE PROMOTING GROWTH 65 (2014), available at <https://www.imf.org/external/pubs/ft/gfsr/2014/02/pdf/c2.pdf> (providing a general discussion on global aspects of shadow banking).

¹⁰⁸ See Hua Zhang, *The Future of P2P Lending in China*, CELENT (Oct. 16, 2013), <http://www.celent.com/reports/future-p2p-lending-china> (providing that the P2P lending market in China has grown from a mere US\$30 million in 2009 to US\$940 million in 2012, and will reach US\$7.8 billion in 2015).

¹⁰⁹ In a controversial case, a businesswoman named Wu Ying was condemned to death at first instance for crimes involving illegal fund-raising. The consideration of social impacts was heavily involved in reaching the judgment. Tang Xiangyang & Ruoji Tang, *Considered Opinion: The Wu Ying Case*, Econ.Observer (Apr. 19, 2011), <http://www.eeo.com.cn/ens/Politics/2011/04/19/199377.shtml>. The Supreme People's Court issued an interpretation on illegal fund-raising and financial fraud in December 2010. Guan yushen li fei fa jizixingshianjianjutiyingyong fa lüruogan wen ti de jieshi [Interpretation on the Specific Application of Laws in the Trial of Criminal Cases of Illegal Fundraising] (Sup. People's Ct., Dec. 13, 2010, effective Jan. 4, 2011) (China). In 2011, the Criminal Law was amended to remove the death penalty in relation to thirteen economic crimes. ZhonghuaRenminGongheguo Xing Fa Xiu Zhang An (Ba) [Eighth Amendment to the Criminal Law of the P.R.C.] (promulgated by the Standing Comm. Nat'l People's Cong., Feb. 25, 2011, effective May 1, 2011).

¹¹⁰ See generally Vivienne Bath, *China, International Business, and the Criminal Law*, 13 ASIAN-PAC. L. & POL'Y J. 1, 1–4 (2011).

¹¹¹ See Liu Weibo, *guānyúshěnlífēifājīxíngshìjūnjīyùnyìngfǎlǚrúogǎnwèntídejiěshì' de lǐjiěyùshìyòng* (《关于审理非法集资刑事案件具体应用法律若干问题的解释》的理解与适用) [On Comprehension and Application about "Interpretation of the Supreme People's Court of Several Issues on the Specific Application of Law in the Handling of Criminal Cases about Illegal Fund-raising"], PEOPLE'S JUDICATURE, 2011 Vol. 5, at 25 (providing that illegal fundraising should embody four elements: illegal, public, profit-baiting, and unspecific targets).

¹¹² See *China mulls eliminating death penalty for illegal fundraising, pimping*, L.A. TIMES (Oct. 28, 2014), <http://www.latimes.com/world/asia/la-fg-china-death-penalty-20141027-story.html> (providing that death penalty is expected to be eliminated from nine crimes, including illegal fundraising). However, it is notable that removing

fundraising. If such a boundary was to be drawn, it must not be arbitrary or contrary to the legislative intent.

The purposes of Articles 169, 176, and 179 of the PRC Criminal Law are to legally protect property rights by implementing proper fundraising channels for production and business operations by promoting management of the financial industry and the public order of the state. As a crime, illegal fundraising protects the public order of the state and the legitimacy of property rights. As long as the property rights of owners are not infringed, fundraising for business operations (excluding monetary and capital purposes) should be regarded as proper, legal behavior. Therefore, legal fundraising should include equity crowdfunding through a publicly accessible Internet platform for business startups or project-based investment financing that is of a commercial nature.

Secondly, the determination of what constitutes the crime of illegal fundraising should contemplate the practicality of enforcing illegal fundraising. As provided by the Supreme People's Court of China, the categorization of illegal fundraising is an attempt to assist and promote the establishment of an orderly capital market but, at the same time, such categorization may hinder the development of private finance. When the high demand of financing cannot be accommodated through official financial channels, private, commercial financing should not be regulated, provided that no harm is done to the management of the Chinese financial market and the public interest.¹¹³ Therefore, the definition of illegal fundraising in the PRC Criminal Law should be narrowed to liberalize the capital market. Additionally, disputes that arise from fundraising or investment contracts are more appropriately resolved in civil suits rather than criminal sanctions. This is especially true for crowdfunding, because the size of an individual contribution to a project is often quite small¹¹⁴ in comparison to the large-scale lending that ordinarily takes place in shadow banking or manipulative operations in the current, inflated real estate market.¹¹⁵ For instance, crowdfunding origins are tied to funding small businesses or innovative ideas; therefore, they should be largely excluded from the scope of illegal fundraising activities.

Thirdly, legislative intent regarding the applicability of PRC Criminal Law to illegal fundraising should be warily construed. On the one hand, if illegal fundraising is implicitly construed in Articles 160, 176, and 179, any obscurity may leave too much discretion to the judiciary to interpret the legislature's intent. On the other hand, the Supreme People's Court's enumeration of what constitutes illegal fundraising may be too narrow or specific,¹¹⁶ and, therefore, it may not cover the true practices of

illegal fundraising from death penalty was intended for lowering less harmful crimes to be subject to death penalty, but such elimination does not show that illegal fundraising is still a tolerable economic activity. See Xinhua, zhuanjiaxiangjiejizhapananzuzhimaiyinjuzuiquxiaoxing yuanyin (专家详解集资诈骗罪组织卖淫等 9 罪取消死刑原因) [Experts Comment on Background of Eliminating 9 Crimes from Death Penalty], China Radio Intl. (Oct. 27, 2014), <http://gb.cri.cn/42071/2014/10/27/3245s4743057.htm>.

¹¹³ See Margaret Lewis, *Criminal Law Pays: Penal Law's Contribution to China's Economic Development*, 47 VAND. J. OF TRANSN'L L., 371, 419–20 (discussing that there remains untapped potential by the Chinese government which uses criminal law to address harmful economic activities).

¹¹⁴ See Weinstein *supra* note 9, at 430.

¹¹⁵ See James R. Barth, Michael Lea & Tong Li, *China's Housing Market: Is A Bubble About to Burst?* 1 (Milken Inst., Working Paper, Oct. 2012), available at <http://fic.wharton.upenn.edu/fic/papers/13/13-05.pdf> (discussing that the mortgage system plays an incentive and indispensable role in promoting but exacerbating the financing or lending practice by Chinese banks).

¹¹⁶ See Ring, *supra* note 26 (the joint news conference organized and sponsored by the Supreme People's Court of China, the Supreme Procuratorate of China, Ministry of Public Security of China, CBRC and CSRC held in April

unlawful private financing. To specify a provision on illegal fundraising is a contingent matter, which brings an onslaught of uncertainties for the development of crowdfunding in China.

Therefore, reformations of Internet banking and micro-finance conflict with the desire to nurture the development of crowdfunding. The current regime for regulating illegal fundraising does not match the essential characteristics of equity crowdfunding in China. Currently, the scope of what constitutes illegal fundraising needs finite boundaries. There are reports that the CBRC and the People's Bank of China will jointly issue an administrative ruling on equity crowdfunding, but it is still too early to realistically project how such a ruling will affect equity crowdfunding and financial reform in China.

B. Amend Provisions on Securities Public Offerings

As a vehicle to raise capital from public investors or everyday individuals, equity crowdfunding clearly falls into the strict governance of PRC Securities Law and other relevant regulations. As PRC Securities Law imposes stringent requirements on public offerings, crowdfunding raisers and platforms take on high risks with project advertisement and locating appropriate investors.¹¹⁷ PRC Securities Law plays a dominant role in regulating the Chinese capital market by setting ground rules and guiding the practices therein.

Initially adopted in 1993, with a few amendments thereafter, PRC Securities Law aims to maintain the order of the Chinese capital market and protect participants' interests in order to build a dynamic and forceful capital market, especially internationally. In contrast to the United States' JOBS Act, which modified the 1933 Securities Act to promote equity crowdfunding, to heighten investors' protections, and to clarify the status of crowdfunding portals,¹¹⁸ PRC Securities Law holds a firm stance on controlling Chinese capital market participants. In fact, the rise of equity crowdfunding is deeply connected to the poorly regulated, administration-oriented capital market and the imbalance of supply and demand in investment financing. Equity crowdfunding, as an imported "matchmaker" vehicle to support small business, not only reduces the threshold of accessing venture financing¹¹⁹ and promotes matching investment and financing needs of investors, thereby strengthening capital usage efficiency,¹²⁰ but equity crowdfunding also plays a pioneering role in improving investor awareness and enhancing venture capital dynamics. Despite the challenges of online financing and micro-finance, PRC Securities Law still holds onto outdated methods, thereby allowing China to fall behind on regulating innovative financing vehicles.¹²¹ Such conservatism

2014 interpreted the scope of illegal fundraising quite strictly by nominating a few specific cases).

¹¹⁷ Zhōnghuá réngōng héngqū fǎ (中华人民共和国证券法) [Securities Law of the People's Republic of China], *supra* note 34, at art. 10 (stipulating that three scenarios should be categorized as a public offering of securities: (1) securities offerings to unspecific targeted investors; (2) public issuance of securities to more than an accumulation of 200 specified investors, and (3) public issuance of securities as prescribed by any other law or administrative regulation).

¹¹⁸ *See generally* Heminway et al., *supra* note 3 (discussing the impacts and functions of the JOBS Act).

¹¹⁹ *See* Bradford, *supra* note 16, at 14–27 (discussing the functions of equity crowdfunding models).

¹²⁰ *See id.*

¹²¹ *See generally* Takeshi Jingu, *Deregulation of China's Securities Industry Is Accelerating* (Nomura Research Inst., Working Paper No. 151, 2012), available at <https://www.nri.com/global/opinion/lakyara/2012/pdf/lkr2012151.pdf> (discussing the deregulation challenges faced by China's securities regime).

needs to be modified by incorporating cutting-edge supervisory measures and receptive incentives in order to accommodate financial innovations.¹²²

Although a few leading Chinese platforms have experimented with equity crowdfunding under the authorities' tolerance, such fundraising still runs the risk of violating the provisions of the PRC Securities Law regarding public offerings.¹²³ Even though paradoxical crowdfunding continues, compliance costs and monitoring efforts executed by capital-seekers and crowdfunding portals are increasingly elevated¹²⁴ as well as the looming threat of being policed by the authorities at any time. Forthrightly, it is unlikely, but also necessary, to amend the provisions on securities public offerings to acknowledge and endorse equity crowdfunding. Alternatively, the CSRC and the CBRC may issue an administrative ruling regarding equity crowdfunding, specifying the rights and obligations of the crowdfunding investor as well as the issuer and platform in order to safeguard individual investors' rights and to standardize the venture capital market. Meanwhile, such an administrative ruling will strengthen the supervision of crowdfunding, thus escalating the regulatory model from a classified supervision to a combination of behavioral and administrative supervision for equity crowdfunding. In summary, the PRC Securities Law and other relevant supervisory authorities should provide a narrower regulatory environment for equity crowdfunding in order to enhance the administration of the investment environment.

C. Refine the Classification and Investment Authority of Investors

The origins of crowdfunding trace back to the microfinance and venture capitalism pioneered by Nobel Laureate Muhammad Yunus.¹²⁵ Essentially, crowdfunding began as a way to establish enterprises or stimulate investment for individuals and startups, which were short on funds or denied traditional financing access by banks.¹²⁶ Usually, such startups or individuals only have an idea or are at rudimentary stages of operation. Under the current regulatory scheme of Chinese equity crowdfunding, before conducting a full evaluation on crowdfunding participants regarding the feasibility of profit levels, the question arises whether everyday individuals are equipped to act as venture capitalists and are willing to accept the risks associated with a failed project. For instance, because equity crowdfunding claims to provide a foreseeable financial return with small-scale capital inputs at higher efficiency, many Chinese investors are often induced by the promise of profits and are likely to make irrational investments without recognizing the risks. This shortsighted opportunism may be further complicated by herd behavior in venture capital, furthering irrationality. Once it becomes evident that a project will fail due to high risks or operational difficulties, the investors will likely receive nothing in return, which destabilizes the financial order and supervision of the market.

To accommodate the irrationality that often persists in equity crowdfunding

¹²² See Jianpeng Deng, *hulianwangjinrongshidaizhongchoumoshi de falvfengxianfenxi* (互联网金融时代众筹模式的法律风险分析) [*Legal Risks Analysis of Crowdfunding in the Age of Internet Finance*], J. JIANGSU ADMIN. INST., Vol. 3 2014, at 120 (providing that the consideration of political stability suppresses the legal framework for private or non-banking financing activities be inactive or dormant).

¹²³ See Part II, *supra*.

¹²⁴ See Hu, *supra* note 29 at 10.

¹²⁵ See Michael Ibberson, *Time For a History Lesson: The Evolution of Crowdfunding*, CROWDCLAN (Aug. 22, 2013), <http://www.crowdclan.com/time-for-a-history-lesson-the-evolution-of-crowdfunding/>.

¹²⁶ See Weinstein, *supra* note 9, at 427–28 (discussing the origins of the crowdfunding and financing needs of small capital seekers).

investments and to avoid subsequent losses caused by such irrational investments, individual Chinese crowdfunding investors should be classified into different groups based on: (1) annual income, (2) net disburseable assets, (3) securities trading record, (4) the experience of the venture capital investment, and (5) the capacity of failure resistance.¹²⁷ Then, appropriate levels of authorization will be assigned to each equity crowdfunding's investors, depending on their classifications. However, such restrictions should not be too narrow to thwart investors from participating in equity crowdfunding investments, nor should such restrictions be too broad to undermine the protections that investor's desire. Therefore, considering the current financing and capital market supervision levels in China, the following proposed scheme classifying potential equity crowdfunding investors may provide guidance.

Firstly, a few boundaries need to be implemented in order to assign the level of investment capacity into which an investor may fall:

Equity Crowdfunding Individual Investor	Low	Medium	High
Annual Income (RMB 1,000)	≤ 200	200-500	≥ 500
Maximum Contribution (percentage of annual income)	10%	15%	20% (accumulated annual investment capped at RMB 500,000)

Secondly, by considering the record on investment profits and losses, individual crowdfunding investors will be allowed to adjust their future ventures in the projects. For example, when an investor achieves positive annual net investment profits, the percentage of the annual amount of investment accounted to annual income can be raised up to 3 to 5 percent; if the investor suffers investment losses, such percentage will be decreased up to 5 to 10 percent.

Finally a cap on the maximum annual amount of crowdfunding investment contribution for each investor should be set at a certain level, such as RMB 1,000,000 per annum for low-level equity crowdfunding an individual investor. This cap will encourage more investors to participate in crowdfunding while removing the concern of abuse.

D. Clarify the Identity and Function of the Equity Crowdfunding Platform

The equity crowdfunding platform plays an indispensable role in vetting stock issuers and protecting investors.¹²⁸ As intermediaries of matching issuers as well as potential investors, crowdfunding platforms also hold important information and data, which requires certain responsibilities due to the sensitive nature of the information.¹²⁹ There

¹²⁷ This categorization model can be traced to the accredited investor classification as stipulated in Regulation D. *See* THOMAS E. VASS, ACCREDITED INVESTOR CROWDFUNDING: A PRACTICAL GUIDE FOR TECHNOLOGY EXECUTIVES AND ENTREPRENEURS 11 (2014) (discussing how federal securities laws define the 8 categories of the tem accredited investor in Rule 501 of Regulation D).

¹²⁸ *See generally* Bradford, *supra* note 16, at 49.

¹²⁹ *See id.* at 72 (discussing that crowdfunding sites provide matching services that are created to promote the purchase

is a registration requirement in China for crowdfunding platforms much like the United States' JOBS Act requirement on "funding portals." In fact, nearly all major equity crowdfunding platforms and websites do not have official recognition from the CSRC as a brokerage¹³⁰ for securities offerings. Such non-recognition brings numerous concerns on regulating and supervising the current operations of Chinese equity crowdfunding platforms.

First, the rights and privileges of such platforms must be delineated and managed. In particular, one major issue is that there are numerous Chinese equity crowdfunding platforms that hold substantial discretion in their intermediary roles. Despite receiving commissions based on crowdfunding transactions, Chinese platforms enjoy the right to revise, terminate, and dishonor certain service terms provided in PRC Contract Law and PRC Securities Law.¹³¹ Regardless, many platforms unilaterally assign additional rights and protections,¹³² whereby the CSRC and other supervisory authorities do not have a sufficiently-sized labor pool to review such specific terms on a typically standard-form crowdfunding service contract.¹³³ Therefore, this loophole must be addressed in order to provide investors more protection and to ensure that crowdfunding platforms are properly regulated.

Second, the responsibilities and obligations of crowdfunding platforms must be outlined. Such obligations should include protecting investors sensitive information, prior and ongoing evaluations and verifications of the crowdfunding project, supervision of securities trading, risk warnings to investors, further investor education, compulsory and voluntary reporting to supervisory authorities, reporting breach of crowdfunding service contracts, and terminating any illegal fundraising.¹³⁴

Finally, a regulatory framework must be available for investors and capital-seekers to report any wrongdoings or improper handlings by crowdfunding platforms, thereby discouraging unfair service terms and conditions in crowdfunding service contracts. Although Articles 39 to 41 of the PRC Contracts Law stipulate protections against any unfair terms of a standard service contract, the virtual inequality of information among crowdfunding participants allows platforms to adopt discriminatory terms in order to dodge responsibilities.¹³⁵ For example, the AngelCrunch service agreement encompasses a total of ten articles in order to exempt or virtually eliminate the platform from obligations, thereby enlarging investors' responsibilities. Admittedly, such inequality in such service agreements partially results from uneducated or irrational investment decisions by investors; however, it also reflects the ubiquitous neglect of the

of entrepreneurs' securities, and the information provided by those small business entrepreneurs is not typically publicly available).

¹³⁰ See *id.*, at 66–67 (providing that, although no definitive answer is available, there is a strong possibility that crowdfunding sites would be considered brokers if they listed offerings of securities). Moreover, the crowdfunding sites' receipt of transaction-based compensation, continued involvement in the investor-entrepreneur relationship, public advertising, and for-profit status may cumulatively be too much to allow them to avoid broker status.

¹³¹ See Hu, *supra* note 29, at 10.

¹³² See Part II, *supra* (Chinese crowdfunding portals have too much discretionary power in monitoring investors through intrusive service terms and conditions).

¹³³ See *Y ñjiānhu ìw ángy ánxì ì: P2Pwǎngd àh ángy èjiānguǎn de sh ì àyú ánz é* (银监会王岩岫：P2P 网贷行业监管的十大原则) [CBRC Vice-Chairman Yanyou Wang, *Ten Guidelines for Supervising P2P and Internet Loan Practices in China*], WANGDAIZHIJIA (Sep. 27, 2014 1:16 PM), <http://news.wangdaizhijia.com/20140927/14330.html>.

¹³⁴ See generally Bradford, *supra* note 16, at 54–63 (discussing duties to be performed by crowdfunding portals).

¹³⁵ See *id.* at 105 (discussing that even crowdfunding exemption is properly structured, it can ameliorate some, but not all, of the risks for the protection of investors).

rights held by investors and capital-seekers in equity crowdfunding. Therefore, the CSRC should issue specific legislation in due course to clarify the rights and obligations of each party in the equity crowdfunding framework and to provide guidelines and regulations, which are currently of great necessity.

5. Conclusion

Crowdfunding is an innovative and dynamic vehicle for small and medium-sized enterprises as well as enthusiastic investors in China; it has gained substantial popularity in a relatively short period of time. Since its initial induction to China in 2009, crowdfunding has developed rapidly, attracting the attention and subsequent supervision from regulators. In addition, crowdfunding has brought a tremendous amount of funds to China's under-stimulated capital market. However, the legal regime regulating crowdfunding has not yet come into full-pledged, well-coordinated efforts due to the various inherent issues in Chinese capital markets, such as the lack of basic trust among the participants of securities offerings, underdeveloped or rudimentary crowdfunding portal models, and fragile confidence in the sluggish recovery of the strictly regulated capital market.

Currently, there is still not an identifiable, unified guideline on how to delineate the significance and prospects of the crowdfunding vehicle. The development of crowdfunding in China faces a few unresolved key issues. The definition of illegal fundraising under PRC Criminal Law and PRC Securities Law is unclear, and such uncertainty may lead to categorize crowdfunding as a public offering, which must obtain prior approval before any subscription of shares through crowdfunding. The risk of illegal fundraising categorization is the Sword of Damocles for Chinese equity crowdfunding. In addition, concerns for fraud in equity crowdfunding and ambiguous identification of crowdfunding portals further complicate the herd behavior of follow-up investors.

Echoing unresolved issues as to equity crowdfunding, a few legislative proposals should be contemplated. Firstly, PRC Criminal Law should clearly stipulate what constitutes an illegal fundraising activity; otherwise, crowdfunding platforms or capital-seekers will have to find alternative, risk-orientated approaches to dodge authority supervision.¹³⁶ Secondly, the circumstances in which crowdfunding will be regarded as a public offering should be provided for in further detail; after all, the purpose of crowdfunding is to create access to issuers that lack traditional financial support in China. The third key issue is that the authority of investors should be finely tuned based on levels of annual income, net assets, and outcomes of crowdfunding projects on self-selection. Lastly, the identities of crowdfunding platforms should be clarified to achieve sound protection of investors' rights and to avoid any fraud by crowdfunding platforms.

Assuredly, Chinese equity crowdfunding has a promising future. Unresolved issues in the current legal regime can and will be tackled given the influence and popularity showcased by crowdfunding. In fact, the CSRC has already conducted research and is orchestrating plans in order to regulate crowdfunding, which shows an intent to support

¹³⁶ See generally *Rénmìnrìbào: Wǎngdài pítái jiānguǎn xièzhì shí chū* (人民日报：网贷平台监管细则何时出) [*People's Daily: Where Is the Internet Loan Regulatory Framework?*], WANGDAIZHIJIA (Nov. 6, 2014), <http://news.wangdaizhijia.com/20141106/15003.html> (urging that China should have a detailed legal framework ready to take the challenges brought by Internet finance including crowdfunding).

novel financing vehicles. The consideration for China's authorities such as the CSRC and the CBRC is to balance the innovation and solidarity of the financial industry and the Chinese capital market as well as to promote an investor-friendly scheme through legally protective measures. In that spirit, this article hopes to factor a positive contribution to China's crowdfunding legal regime.