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To: Our Clients and Friends

Convertible Bond as A Private Equity Investment Tool in China[1]

I. Overview

As a crossover between debt and equity instruments, convertible bonds or CBs as commonly used in international PE and VC investment community are very popular in the developed financial markets. In a typical CB deal, the investor extends debt financing to the target company/borrower and becomes bondholder first. The CBs can be converted into the borrower's shares later on at the investor's election (*but not obligation*) upon prescribed terms and conditions, turning the investor into a shareholder of the borrower company. CB investments are reasonably convenient and efficient for transaction parties in terms of bond issuance, transfers and conversions. Principal terms of a CB usually include the term and maturity, interest rates, price and other conditions of conversion, and put-back rights, among others. To further protect investor/bondholder's interest, the underlying CB terms may also address anti-dilution, liquidation preference, conversion price adjustments, issuer's guarantee, bondholder's pre-emptive rights, investor's consent rights, and etc. Compared to creditors in a straightforward debt investments and shareholders in a direct equity investment, CB holders are usually deemed to have obtained more flexibilities as they could enjoy more of the upsides of their investments while in the meantime minimizing the downsides.

In China, the existing law only allows qualified listed companies to issue CBs with restricted terms through public offering (instead of private placement) upon CSRC's prior approval,[2] while CB holders are basically not allowed to decide on any

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[1] Solely for the purpose of this memorandum, "China" or the "PRC" refers to mainland China, excluding Hong Kong, Macao and Taiwan. In addition, a few common abbreviations have been used in this memorandum (e.g., CSRC for the China Securities Regulatory Commission, MOFCOM for the Ministry of Commerce, SASAC for the State-Owned Asset Supervision and Administration Commission and FIEs for foreign invested enterprises).

[2] Qualification requirements for public CB placements include, among others, the weighted average net assets income rate of the issuer in the recent three fiscal years shall not be less than 6%, the CB term shall be between 1 and 6 years, and the conversion price shall not be lower than the average trading price of the issuer's shares in the last 20 trading days and in the day immediately before the issuer files its offering prospectus.

operational issues of the borrowers. As a trial program and starting from May 2012, unlisted but qualified small and medium-sized enterprises ("SMEs") are allowed to issue bonds including CBs with restricted terms to qualified investors through private placements upon registration with Shenzhen or Shanghai Stock Exchange. This program was welcomed as an encouraging reform for both investors and borrowers to embrace convertible bonds in Chinese capital market, but it is still not a typical CB familiar to PE and VC investors and so far seems to be rarely used in practice.

II. Structuring A *de facto* CB in China

Under current PRC legal framework, the best way for PE and VC investors to exploit the benefits of a typical CB would be to structure the investment as a "*debt plus call option*" arrangement. The arrangement will be mainly subject to the free will of the transaction parties and generally be governed by the *Contract Law*, the *Secured Interest Law*, the *Administrative Measures for Registration of Corporate Debt for Equity Conversion* and the *General Rules for Loans* of the PRC, among others, rather than any specific rule applicable to issuance of securities in China.

1. The Structure

The *debt plus call option* structure could be summarized as follows: (i) the investor[3] lends money to the target company through a so-called entrusted loan arrangement,[4] which lending is usually secured by guarantees or collaterals provided by the borrower and/or its principal shareholder(s), (ii) the borrower and/or its shareholder(s) concurrently grant the investor an option to subscribe for new shares or buy old shares from the existing shareholder(s) at the investor's election pursuant to the pre-agreed price and other terms and conditions before or upon the maturity of the loan, and (iii) the consideration for lending and share subscription/purchase will then be appropriately offset by the parties so that the investor enjoys the right to *convert* its loans into the equity interest in the borrower (*from the financial and taxation perspectives the old share purchase approach could be a bit more complicated than the new share subscription approach*).

Documentation wise, this *debt plus call option* structure would involve such principal legal documents as the entrusted loan agreement, the call option agreement (for increase in registered capital and/or old equity transfer), the guarantee/security instrument, the amended and restated articles of association of the borrower, and shareholders agreement, among others. To protect the investor's interest, customary legal and business terms on such issues as prepayments of the entrusted loan, adjustments of the subscription or purchase price, anti-dilution mechanism, preemptive rights and adequate consent rights will need to be negotiated and properly addressed in the underlying documents.

In addition, if the investment involves an FIE borrower or constitutes a foreign related M&A, the consequent capital increase and/or equity transfer will become subject to prior approval by the competent MOFCOM office, where the reasonableness of the relevant transaction terms (*e.g., the subscription or purchase price*) may be examined and re-evaluated. Further, if a PRC

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[3] Due to foreign exchange control and other reasons, this structure is generally not feasible for foreign investors without an establishment in China to invest in domestically funded PRC companies.

[4] Non-financial entities are not allowed to engage in lending business in China pursuant to the *General Rules for Loans*, but they can lend money through financial institutions (acting as agents) to other entities, which is called an "entrusted loan arrangement".

state-owned enterprise is targeted, rules for acquisition of state-owned assets should generally be followed. Depending on specific circumstances, this usually means additional procedures and transaction steps including evaluation of state-owned assets/equity by qualified SOE asset appraisal firm, approvals by or registrations with competent SASAC office, and even the completion of a statutory auction sale that could really prolong and complicate the transaction process.

2. Potential Legal Risks

For investors, the major legal risk under this *debt plus call option* arrangement would be whether they can enforce the call option if the borrower breaches the contract. Technically speaking, without the borrower company and its shareholders' cooperation, it would be difficult for investors to unilaterally accomplish the proposed capital increase and/or equity transfer pursuant to the underlying call option agreement. Further, although the *debt plus call option* arrangement should be legally enforceable so long as it is generally concluded based on the parties' free will and principle of equality and does not violate any mandatory PRC law, judicial enforcement in China could turn out to be very time-consuming with the outcome not very predictable.

To mitigate the risks, adequate security and guarantees are suggested to be obtained by investors from their counterparties. Further, clear and tightly drafted languages on investor protections as well as the default liabilities on the borrower side under the transaction documents will always be a great help.

Overall, this *debt plus call option* structure is possibly the best available alternative for investors seeking CB type of investments under the current PRC law and practice. Both commercial and legal advantages and risks should however be evaluated and well balanced on a case by case basis.

III. Future Development

As mentioned above, it is going to take a bit more time for the CB structure to become localized in China since it would require some significant alterations to some of China's basic corporate, commercial and financial rules including the *PRC Company Law*, *Securities Law*, the *General Rules for Loans*, among others. The encouraging news is that, following the trial program for SMEs to issue bonds, some further experimental reforms are also being developed in the Chinese capital market. Among other things, CSRC has circulated a draft *Provisional Administration Measures for Issuance of Corporate Bonds* for public comments early this year to allow all unlisted corporate entities to issue corporate bonds including CBs, while the head of the PRC central bank is also calling for revitalization of the Chinese capital market by introducing mezzanine capitals including CBs and preferred shares. We expect that an increasing number of financial and financing tools will come into being along with the country's deepened economic reform and market liberalization.

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The above is a brief discussion of CBs in the Chinese context and is for your general reference purpose only. It may not be relied as a PRC legal opinion in any event.

If you have any questions, please feel free to contact us at inquiry@hanyilaw.com.

中国法下的私募可转债投资简述[5]

一、 私募可转债简介

可转债在国际私募股权投资活动中被广泛使用，目前在境外已发展得非常成熟。典型的可转债私募股权投资（简称“私募可转债”）因兼具债权投资和股权投资的特点而受到广大投资者的青睐。在典型的私募可转债中，投资人先以债权人的身份向目标公司提供融资，并且有权（但无义务）选择在适当的时机、基于一定的条件和程序，将其持有的目标公司的债券以事先约定的价格转换为目标公司的股票，从而成为目标公司的股东。私募可转债操作相对简便，且具有一定的流动性，其主要交易条款包括债券的期限和利息、转换价格及转换的条件和条款、回售条款等。为进一步保护债券持有人的利益，一些可转债还会加入债券清偿顺序、转换价格调整、担保、反稀释、债券持有人对发债人后续新发证券的优先购买权及对发债人特定重大事项的参与权或否决权等条款。与单纯的债权/债券投资相比，可转债持有人对发债人的重大经营事项可以享有一定的参与权，并且有机会以股东身份分享目标公司的增长红利；而与直接进行股权投资相比，可转债在投资风险防范方面又具有很大的优势，在目标公司经营状况不理想、投资人放弃转股的情况下，属于债权性质的可转债将优先于股权得到偿付。因此，在遇到发展潜力大但同时投资风险也较高的目标公司时，不少投资人往往偏好使用私募可转债作为投资工具。

中国的法律法规目前还没有为私募可转债的发行提供明确的法律依据，其明文允许的、实践中也较多见的主要是符合条件的上市公司以公开方式发行的可转债，即上市公司公募可转债。该等可转债的发行需事先获得中国证监会的批准，并且符合法律对于发行人资格条件、可转债基本条款等方面的要求和限制（*比如发行人最近 3 个会计年度加权平均的净资产收益率不得低于 6%，可转债的期限应在 1 至 6 年之间，转股价格不得低于募集说明书公告前 20 个交易日该公司股票交易的均价和前一交易日的均价等*），可转债持有人对发行人的重大经营事项一般也不享有参与权或否决权。

2012 年 5 月，中国启动中小企业私募债试点，符合条件的未上市中小企业可以在深交所或上交所以非公开方式向合格投资者发行债券（利率、每期发行对象的人数等均受到限制）。债券发行毋须证监会审批，只需事前向交易所备案，但须由证券公司承销，发行后也可以转让。试点文件明确允许发行人为私募债券附设认股权或可转股条款，被认为是向私募可转债方向迈进的一步，但试点文件并未就此作出进一步规定。从目前非常有限的公开信息来看，在过去一年多的实践中，只有少数私募债券设置了转股条款。究其原因，一方面，中小企业受其规模所限且未来发展的不确定性较高，一般投资者对转股选择权的兴趣不大。另一方面，目前私募债券的买家主要是银行等金融机构，私募股权机构还鲜有参与，这些投资者从市场因素和规管限制等角度出发通常不考虑、也不太适合未来成为发债中小企业的股东。

二、 私募可转债在现有中国法律框架下的实现

尽管中国法律尚未明确允许公司发行私募可转债，但在实践中，投资人和目标公司还是可以通过债权附加增资或购股选择权的投资模式，实现接近于可转债效果的私募股权投资。鉴于该等投资主要通过合同约定的方式实现，其本质上与证券发行无关，故不受中国证监会或证券交易所的规管。适用于该等投资的主要法律法规包括《合同法》、《担保法》、《公司债权转股权登记管理办法》、《贷款通则》等。

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[5] 仅为本备忘录之目的，“中国”一词指中国大陆，不包括港澳台地区。

1. 具体操作

债权附加增资或购股选择权投资模式，简单而言即境内投资人[6]通过中介金融机构向目标公司提供委托贷款[7]（同时目标公司或其主要股东就贷款向投资人提供一定的担保），同时，投资人与目标公司及/或其现有股东约定，在贷款期满前，投资人有权要求按照事先约定的价格和条件向目标公司增资，或从目标公司的主要股东处购买相关股权/股份（但此种情形将涉及更为复杂的财务和税负等问题），以达到投资人将其对目标公司的贷款债权转化为目标公司股权的目的。

在债权附加增资或购股选择权投资模式下，投资人与目标公司方面除需签署委托贷款法律关系下涉及的委托贷款合同及担保文件外，通常还需签订涉及债转股安排的增资或购股选择权协议等文件，以明确约定投资人可以基于其对目标公司的债权选择入股目标公司的时机、条款和条件，并视情形就提前还款、价格调整、反稀释、股权回购等事项作出适当的约定。此外，投资人还可以进一步要求对目标公司的章程、股东协议等文件作出必要的修订，增加投资人对目标公司重大事项的参与权或否决权等，以保护自身利益。

另外，如果目标公司为外商投资企业或涉及外资并购，则在投资人行使选择权时，相关增资或股权转让还需经商务主管部门事先批准，届时审批部门有可能也会关注增资或转股的对价是否基本合理等。如果涉及国有资产，相关增资或转股还应按照有关规定履行国有资产评估、审核/备案、进场交易等程序，且交易价格须以评估值为基准，这意味着当事方不一定能够按期望的价格和条件完成交易。因此一般而言，债转股在涉及国有资产的投资中并不多见。

2. 主要法律风险

对投资人而言，上述债权附加增资或购股选择权的投资模式下目前最主要的法律风险是增资或入股选择权约定的履约风险。通常情况下，投资人无论通过增资还是购股的方式成为目标公司的股东，均需要目标公司方面的配合，方能办理增资或购股所需的验资、审批及工商登记等手续（视情形而定），但在目标公司或其现有股东违约或不予配合的情况下，投资人能否通过司法程序申请强制执行成为目标公司的新股东，在实践中还是有较大的不确定性。

应当说，债权附加增资或购股选择权的约定符合中国合同法的意思自治原则，交易文件只要没有违反中国法律法规的强制性规定，理论上就应该合法有效并具有执行力。但考虑到相关安排除也涉及公司法下（尤其是有限责任公司）的人合性，对目标公司经营稳定性的维护以及强制公司方执行增资或购股约定的现实难度等因素，投资人未必能够顺利通过司法途径强制公司方履行当初的转股约定。

因此，除要求目标公司及/或其主要股东提供适当的担保及惯常的保护性权利外，投资人与公司方就增资或购股选择权约定的违约责任作出严格的约定将至关重要。这一方面将有助于阻却公司方的违约意图，另一方面在违约实际发生时，也将有助于减少投资人的损失。此外，在相关投资交易文件中，还需要根据项目的具体情况来考虑和设计投资人的行权机制及与其他现有股东权利的协调等事项，以求减小股东

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[6] 受外汇管制等限制，境外投资人目前还很难以此处提及的方式直接投资中国的内资公司。

[7] 鉴于《贷款通则》不允许企业之间直接借贷，因此投资人通常需要通过委托贷款等方式向目标公司提供贷款。

之间的权利冲突，提高投资人转股的可行性。

基于上述，在目前的法律及实践背景下，尽管股权附加增资或购股选择权的模式较为接近私募可转债投资，但考虑到该模式也存在其结构性的履约风险，故就某一具体的投资项目而言，投资人还需从投资成本、风险和收益等角度综合考量，以确定是否采取该种债转股的投资模式。

三、 近期发展和未来立法展望

我们注意到，近期的一些立法动态开始体现资本市场进一步融资改革的趋势。比如中国证监会的《公司债券发行管理暂行办法（讨论稿）》已于今年年初在业内征求意见，拟在中小企业债试点的基础上，允许所有公司制法人通过私募的方式发行包括可转债在内的公司债券，并允许一定的创新。此外，央行行长最近也公开表示，资本市场需要引入优先股发挥独特作用。当然，要在中国实现真正意义上的私募可转债，尚待多项基本的法律法规作出调整和修改，比如《公司法》需要允许未上市公司发行可转债，《贷款通则》有关企业之间不得直接借贷的限制也需作出修改等等。

中国的法律法规正在不断的修订和完善中，投资界也一直不乏创新。我们期待私募可转债、优先股等更灵活的融资工具的真正实现，从而为投资人提供新的投资路径和更加便捷、稳妥的投资环境。

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以上是我们对中国目前法律和实践中可转债在私募股权投资中的操作模式和相关法律风险的简要介绍和探讨，希望对投资人有所裨益。本备忘录仅供阁下作一般性参考，并不能视为我们就相关事项出具的正式法律意见。

如阁下对本备忘录之内容有任何疑问，敬请随时与敝所联系（inquiry@hanyilaw.com）。

2013 年 10 月 30 日