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Legal Commentary



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Private Equity Law

NDRC Expanding Mandatory Record-filing Requirements for Private Equity Funds to Nationwide

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On January 31, 2011, National Development and Reform Commission (“NDRC”) issued *NDRC Notice on Further Regulating the Administration on Development and Filing of Equity Investment Enterprises* (Fa Gai Ban Cai Jin [2011] 253 Hao)(the “253 Notice”), which requires equity investment enterprises registered in the pilot areas with a capital size more than RMB 500 million to be subject to NDRC’s record-filing and standardized operation administration and disclose relevant information accordingly. After that, it is said that NDRC tends to promote such administration system to a nationwide scale. On November 23, 2011, NDRC issued *NDRC Notice on Promoting the Standardized Development of Equity Investment Enterprises* (Fa Gai Ban Cai Jin [2011] 2864 Hao)(the “2864 Notice”), which launched a national program concerning mandatory record-filing, standardized operation and information disclosure administration of equity investment enterprises .

Mandatory Record-filing Administration

1. Scope of Record-filing Administration

Equity investment enterprises engaging in equity investment business which are not traded publicly in China (including PE Funds whose investment focusing on equity investment enterprises.) should apply for record-filing in accordance with the 2864 Notice within one(1) month after registration with the administrative departments for industry and commerce, except for equity investment enterprises 1) having completed the record-filing process for venture capital enterprises in accordance with the *Interim Administrative Measures for*

Venture Capital Enterprises; and 2) that are funded and established by a sole entity or natural person, or by two or more investors that are wholly owned subsidiaries of the same entity. Should the equity investment enterprises entrust their assets to be managed by other equity investment enterprises or equity investment management enterprises, the entrusted management institutions should apply for supplemental filings. However, the equity investment enterprises and the entrusted management institutions established before the implement of the 2864 Notice should apply for record-filings within three (3) months since the announcement of the 2864 Notice (before February 23, 2012.)

2. Subjects of Application

If an equity investment enterprise adopts an internal management, the enterprise shall be responsible for going through the record-filing procedures. If an equity investment enterprise adopts the entrusted management, its entrusted management institution shall be responsible for going through the relevant record-filing formalities.

3. Jurisdiction

Equity investment enterprises having the capital size (including the capital contribution that has actually been paid in and the capital contribution subscribed by investors) that is more than RMB 500 million or its equivalent in foreign currencies should apply for recording-filing with NDRC; while others having the capital size that is less than RMB 500 million or its equivalent in foreign currencies should apply for recording-filing with the administrative department designated by the provincial people's government (the provincial administrative department).

4. Procedures

The applying subject shall submit the relevant record-filing materials to the relevant provincial administrative department responsible for assisting record-filing process at the place where the equity investment enterprise is domiciled for preliminary examination. Within 20 working days after receiving the record-filing submitted application, the provincial administrative department shall produce the preliminary examination opinions and submit the same to NDRC. If the equity investment enterprise is required to apply for a recording-filing at the provincial level, with the provincial administrative department's confirmation that the application materials submitted by the equity investment enterprise are complete, the provincial administrative department shall complete the record-filing process with the applicant's name and basic information being published on its official website. After receiving an equity investment enterprise's record-filing application forwarded by relevant local administrative department responsible for assisting record-filing, together with the preliminary examination opinions issued thereby, NDRC shall complete the relevant

record-filing process within 20 working days if the application qualifies the re-examination.

The record-filing process shall include publishing the applicant's name and basic information on the official website of NDRC.

5. Supervision

With regard to equity investment enterprises and their entrusted management institutions that have completed the record-filing formalities, the relevant departments shall, within five months after the end of each accounting year, conduct an annual inspection thereon regarding their compliance with this 2864 Notice. Where necessary, the relevant departments shall conduct inspection on the business operation of equity investment enterprises by all kinds of means.

6. Punishment

In the case of discovering that an equity investment enterprise or its entrusted management institution fails to comply with Notice in its business operation, the relevant department shall urge the company or institution to make rectifications within twenty (20) working days. Enterprises or institutions fail to make rectifications within specified time limits shall be regarded as the "equity investment enterprises or entrusted management institutions with operation management not complying with regulations" and shall be announced to the public through the official website of the relevant department.

Standardized Operation Management Mechanism of the Equity Investment Enterprises

1. Requirements and New Regulations

The 2864 Notice has continued the standardized operation requirements of the equity investment enterprises set forth in the 253 Notice, including:

- (1) Establishment and Management. The Notice emphasizes that equity investment enterprises must be established in accordance with relevant provisions of the PRC Company Law or the PRC Partnership Enterprise Law. Equity investment enterprises established in the form of limited company or joint stock limited company may implement self management or entrust other equity investment enterprises or equity investment management enterprises.
- (2) Capital Raising. The capital of an equity investment enterprise may only be raised from specific targets through private placement, and recommendations shall not be made directly or indirectly to non-specific non-qualified targets through publishing

announcements in the media (including all kinds of websites), posting up notices in communities, handing out leaflets to the public, sending short messages to the non-specific public who are mobile phone users, or holding seminars or speeches, or other activities in public, whether or not in disguised form, (including putting placement prospectuses at the counters of institutions such as commercial banks, securities companies and trust investment companies). The party responsible for raising the capital fund for an equity investment enterprise shall fully disclose to investors the information pertaining to the investment risks and the potential investment loss, and shall not promise investors that the principal or a fixed return is guaranteed.

- (3) Subscribed Capital. All investors may only pay for their subscribed capital contribution with the monetary fund that they legally own. Subscribed capital contribution may be paid according to the commitment system, which means that investors shall sign the letter of undertaking regarding the payment for subscribed capital contribution at the stage when an equity investment enterprise raises capital fund, and pay for their subscribed capital contribution in installments according to the articles of association of the equity investment enterprise or as agreed in the partnership agreement.
- (4) Investment Scope. The investment scope of an equity investment enterprise is limited to the equities of enterprises which are not traded publicly, and during the investment process, idle fund may only be deposited in banks or used for the purchase of fixed income investment products such as government bonds. The investment orientation shall comply with the State's industrial policies, investment policies and macro-economic control policies. Projects invested by an equity investment enterprise shall be subject to provisions on the examination and approval of fixed assets investment projects. When making any investment, a foreign-invested equity investment enterprise shall go through the formalities for the verification and approval of the investment project in accordance with the relevant provisions of the State.
- (5) Investment Risk Control. An equity investment enterprise shall not provide guarantee for enterprises other than its investee enterprises. Where an equity investment enterprise intends to invest in its associated parties, it shall implement the system for the withdrawal of associated parties when making investment decisions, which shall be stipulated in its legal documents of association.
- (6) Performance Incentive and Risk Control Mechanism. Legal documents of association of an equity investment enterprise and its entrusted management institution shall explicitly set forth the performance incentive mechanism, the risk control mechanism, as well as the decision-making procedures of the relevant investment operation. An equity investment enterprise may stipulate its operation period in its legal documents of association.

- (7) Inspection and Assessment on the Entrusted Management. The equity investment enterprise may, pursuant to the articles of association or the entrusted management agreement, on a regular or irregular basis, examine and evaluate the investment operation status of the equity investment enterprise's capital operation.
- (8) Entrusted Management Institutions. The 2864 Notice clearly states the duties and responsibilities as well as the resignation of the entrusted management institution. It also explicitly requires that an entrusted management institution shall handle property of different equity investment enterprises separately and impartially.

It's worth noting that, the 2864 Notice made a further clarification based on the 253 Notice regard to the following points:

- (1) Number of Investors. The number of investors shall comply with the PRC Company Law (less than 50 for a limited liability company; 2-200 for a joint stock limited company) or the PRC Partnership Enterprise Law (2-50 for a limited partnership). Where the investor is in the form of a collective investment trust, partnership and any other non-legal institutions (except for the "Mother Fund"), the ultimate investors (including the natural person and the legal institutions) shall be taken into consideration for qualification and quantity verification.
- (2) Assets Custodian. The assets of the equity investment enterprise shall be placed in the custody of an independent custodian institution, except that all investors agree to exempt from such assets custody. If the management institution entrusted by an equity investment enterprise is a foreign-invested enterprise or a Sino-foreign equity joint venture, the assets of that equity investment enterprise shall be placed in the custody of the custodial institution with legal person qualification within the territory of China.

2. Punishment for violating the standardized operation requirements

In the case of discovering that an equity investment enterprise or its entrusted management institution fails to comply with the 2864 Notice in its business operation, the relevant department shall urge the company or institution to make rectifications within six months. Enterprises or institutions fail to make rectifications within specified time limits shall be regarded as the "equity investment enterprises or entrusted management institutions with operation management not complying with regulations" and shall be announced to the public through the official website of the relevant department.

Information Disclosure Systems

The 2864 Notice requires an equity investment enterprise shall disclose to investors in

accordance with the articles of association and the partnership agreement and also within four months after the end of each accounting year, submit to the relevant administrative department the annual business report and the annual financial report audited by an accounting firm. The entrusted management institution and custodial institution of an equity investment enterprise shall, within four months after the end of each accounting year, submit to the relevant administrative department the annual asset management report and the annual asset custodial report. Furthermore, in the case of occurrence of the following major events during the investment operation process, an equity investment enterprise shall report to the relevant administrative department within ten working days:

- (1) Amendments are made to documents such as the articles of association, the partnership agreement and the entrusted management agreement of the equity investment enterprise or its entrusted management institution;
- (2) The equity investment enterprise or its entrusted management institution carries out capital increase or decreases, or makes external debt financing;
- (3) The equity investment enterprise or its entrusted management institution is involved in division or merger;
- (4) The entrusted management institution or the custodial institution of the equity investment enterprise involve any major changes, including the change of the senior executives of the entrusted management institution and other major changes; and
- (5) The equity investment enterprise is dissolved or goes bankrupt, or its assets are taken over by a receiver.

The information disclosure system is in accordance with that set forth in the 253 Notice.

Since the 2864 Notice just come on stage, there is still some uncertainty in practice. The analysis thereof is subject to further update according to the new development of relevant policies. We will continue to keep an eye on the problems to be clarified in the mandatory record-filing and standardized operation administration and information disclosure system as well as other possible regulations to be announced and will prepare timely reports.

The Fund Formation and Management Team of Han Kun Law offices is at the forefront in the fund formation field in China. We have already establishes more than ten (10) RMB funds for our clients in more than twenty (20) provinces and cities in China. Should you have any questions, please feel free to contact us.

Important Announcement

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