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Private Equity Law

Detailed Rules for the Overseas Investment with Insurance Capital to Broaden the Fundraising Channels for Overseas Private Equity

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Following the joint issuance of the *Interim Measures for the Administration of Overseas Investment with Insurance Capital* (the "**Interim Measures**") by the China Insurance Regulatory Commission (the "**CIRC**"), the People's Bank of China and the State Administration of Foreign Exchange on June 28, 2007, the CIRC announced the *Detailed Implementing Rules for the Interim Measures for the Administration of Overseas Investment with Insurance Capital* (the "**Implementing Rules**") on October 12, 2012. On the basis of the Interim Measures, the Implementing Rules, by means of specifying the qualification of the parties to, investment products, and investable countries and regions of overseas investments with insurance capital, further broadens the methods for using insurance capital.

Investment Scope

The appendices of the Implementing Rules list 25 developed markets, 20 emerging markets, and 14 futures and options exchanges that are investable for insurance capital, which cover nearly all of the major markets worldwide. Although insurance capital has already been permitted to be invested into mature capital markets "globally" by the Interim Measures, no definition of "mature" was given under the Interim Measures, and in practice, overseas investments with insurance capital have been limited to stocks and bonds in the Hong Kong market. The Implementing Rules are widely believed to serve to expand the investable regions of overseas investments with insurance capital from the Hong Kong markets to 25 developed markets and 20 emerging markets. Notwithstanding any possible misunderstandings by the media towards the Interim Measures, it is apparent that since the introduction of the Interim Measures in 2007. The refinement and clarification of the investable market by the Implementing Rules is undoubtedly a sign of strong support for establishing a broader overseas investable market for insurance capital.

Investment Types

With respect to investment types, the Implementing Rules, for the first time, propose that insurance capital can be directly invested into overseas real estate, provided that such investment shall be limited to mature commercial and office real estate that have the potential to provide stable income and are located in the core areas of major cities in developed markets. The Implementing Rules also further refine the three investment types provided under the Interim Measures. In particular, the Implementing Rules clarify that insurance capital can be directly invested into the equity of unlisted enterprises, provided that such investment shall be limited to the equity of enterprises engaging in finance, aged care services, healthcare, energy, resources, automobile services or modern agriculture.

The Implementing Rules also stipulate the requirements for overseas funds investable with insurance capital (including but not limited to securities investment funds, private equity funds, and real estate investment trusts). In regards to private equity funds (the "**PE**") to be invested, the Implementing Rules not only specify the requirements on the size, personnel, governing structure, stability, and risk control of the PE itself, but also regulate the size of and assets managed by the equity investment institution initiating and managing the PE. Furthermore, insurance capital is prohibited to be invested in an overseas PE where a financial institution directly or indirectly holds de facto control over its management and operation or hold a general partnership interest therein. With the introduction of the Implementing Rules, domestic insurance institutions will become represent a large group of potential institutional investors for overseas PEs (including competent fund of funds), in addition to those few existing large Chinese institutional investors like China Development Bank and China Investment Corporation. As a result, the introduction of the Implementing Rules will make a new source of capital available to global PE markets.

Risk Control

In view of the special nature of insurance capital as life insurance money to policyholders, the safety of the operation of such capital is critical. Therefore, risk control is of great importance when opening overseas investments with insurance capital. Based on the Interim Measures, the Implementing Rules further emphasize the use of risk control in overseas investments with insurance capital from the following aspects, including but not limited to:

1. Higher Requirements for the Qualifications of the Parties

In regards to the qualifications of the parties in an overseas investment with insurance capital set forth in the Interim Measures, the Implementing Rules specify the requirements regarding professional experience in investment or management, proprietary assets or assets under custody. The following represents a selection from the requirements:

1) a trustor's solvency adequacy ratio is not lower than 120% at the end of the quarter before an investment is made;

2) the total amount of assets entrusted to a domestic trustee's management in the most recent fiscal year is not less than RMB10 billion and the insurance capital entrusted to the management of a domestic trustee may only be invested in the Hong Kong market;

3) the average amount of assets under an overseas trustee's management is not less than USD30 billion or an equivalent amount in other freely convertible currencies in the most recent year, and the total amount of assets of non-affiliated parties under its management is not less than 50% of the total amount of assets under its management or not less than USD30 billion or an equivalent amount in other freely convertible currencies;

4) a custodian's paid-in capital or net capital in the most recent fiscal year is not less than RMB30 billion and total amount of assets under its custody is not less than RMB200 billion.

The Implementing Rules further provide that a custodian or a custodian's agent shall not have any of the following relationships with a trustor:

1) where one party directly or indirectly holds over 10% equity interest in the other party;

2) where a third party directly or indirectly holds over 10% equity interest in both parties; or

3) other affiliation relationships determined by the CIRC.

If a custodian or a custodian's agent has any of the above-mentioned relationships with its trustor, an effective risk insulation mechanism will be established and insider trading or interest transfer shall be prohibited.

2. Limited Overseas Investment Ratios

The Implementing Rules, following the limits on the investment ratios set forth in the Interim Measures, provide that the balance of the overseas investments of an insurance institution may not exceed 15% of its total assets at the end of the preceding year and the balance of its investments in emerging markets may not exceed 10% of its total assets at the end of the preceding year. As to a single investment of an insurance institution, the ratios of its investments of various types domestic and overseas shall be calculated on a consolidated basis and subject to any ratio restriction on domestic investments of the same type. Moreover, the Implementing Rules stipulate limits on the amount and term of the short-term lending or borrowing of funds in overseas investments with insurance capital.

3. Prohibited Investments

The Implementing Rules stipulate that overseas investments with insurance capital shall not be involved in the following activities:

1) investing in physical commodities, precious metals or certificates representing precious metals or commodity derivatives;
2) raising funds through securities institutions, buying securities or participating in short sales without holding the underlying assets; or
3) borrowing funds in any form except for the purpose of settlement of transactions.

4. Risk Control in Derivatives Transactions

The Implementing Rules permit the use of financial derivatives for investment risk hedging, provided that the total value of the subject matters of the derivative contracts, the total amount of charges, option fees and margins for the operation of financial derivatives, the total mark-to-market exposure of any counterparty to over-the-counter trading in each working day, and the qualifications of a counterparty in over-the-counter trading are subject to certain requirements and restrictions set forth therein.

5. Regular Reporting Obligations

In order to further the disclosure and reporting system of material and/or specific events set forth in the Interim Measures, the Implementing Rules establish a regular reporting obligation for trustors and trustees, which ensures the timely and efficient supervision and management of the CIRC on overseas investments with insurance capital.

6. Standard Agreements

Whereas the Interim Measures require that trustors shall enter into written agreements with their trustees and custodians, the Implementing Rules specify that specialized lawyers who have at least three years' relevant practice experience shall be engaged in expressing legal opinions on such agreements, which represents a higher requirement for the normalization and authenticity of relevant agreements.

Conclusion

Data from the CIRC indicates that by the end of 2011, the total assets of the insurance industry in the PRC reached RMB6.01 trillion. This was calculated under the criteria that the balance of overseas investments of an insurance institution may not exceed 15% of its total assets at the end of the preceding year as provided under the Implementing Rules. Currently, insurance capital in the PRC available for overseas investment amounts to RMB900 billion (among which RMB600 billion are available to be invested in emerging markets). As more insurance institutions start to engage in overseas investments, these institutions will certainly come to play an important role as a new group of investors in overseas private equity funds.

Important Announcement

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