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Shenzhen Launches its QFLP Pilot Program

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The Shenzhen Special Economic Zone has always been one of the most important Chinese cities for private equity funds. On June 27, 2012, the State Council promulgated the *Reply of the State Council on Policies Supporting the Development and Opening-up of the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone* (《国务院关于支持深圳前海深港现代服务业合作区开发开放有关政策的批复》)(Guo Han [2012] No.58) (the “**State Council Reply**”). The State Council Reply supports the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone’s (“**Qianhai**”) pioneering policies on financial reform and innovation, which makes Qianhai into a so-called “special zone of the special zone” and brings new opportunities for the further development and innovation of private equity funds in Shenzhen.

In the first step of implementing the State Council Reply, Shenzhen pushed for the development of foreign-funded equity investment by promulgating *The Interim Measures for the Launching of a Pilot Program for Foreign-funded Equity Investment Enterprises in Shenzhen*(《关于本市开展外商投资股权投资企业试点工作的暂行办法》)(Shen Fu Jin Fa [2012] No.12) (the “**Interim Measures**”) on November 26, 2012. Jointly formulated by the Shenzhen Financial Services Office, Shenzhen Economy, Trade, and Information Commission, Shenzhen Market Supervision Administration, and Qianhai Administration Bureau, the Interim Measures indicate that the QFLP program of Shenzhen has now officially begun.

The Shenzhen QFLP program has many similarities with the Shanghai QFLP program with regard to the threshold for the limited partners of pilot foreign-funded equity investments, while being silent on the quota of the settlement of foreign exchange for investment purposes. It is said that the current Shenzhen government has reported and applied to the State Administration of Foreign Exchange for the QFLP quota. Formulating policies that enhance the QFLP’s actual used quota of foreign exchange settlements and stimulate QFLP capital to

invest in the local real economy is one of the most difficult problems that pilot QFLP local governments are currently working to resolve. As far as we know, unlike providing a separate foreign exchange settlement quota to each of the pilot PE funds in Shanghai, Shenzhen may be expected to create new innovative ways for the approval of foreign exchange settlements by virtue of Qianhai's policy advances of Qianhai. An example of this might include Shenzhen requiring pilot PE funds to submit materials of investment projects first, and then determining the actual foreign exchange settlement quota for the single project in accordance with the soon-to-be promulgated supportive policy for new strategic industries, so as to solve the aforesaid difficult problem. However, considering the policy demands of controlling "hot money," it is still uncertain whether such a form of approval for foreign exchange settlements can be passed and implemented.

Moreover, there is no "national treatment clause"¹ like the Shanghai QFLP in the Interim Measures. It has been reported that Shenzhen hopes to appropriately extend the project investment limitations of the pilot foreign PE funds registered in Qianhai, and increase such funds' share proportions within the framework of the *Catalogue of Industries for Guiding Foreign Investment*. However, under the broader policy background that the National Development and Reform Committee (the "NDRC") issued in *The Reply Letter of the General Office of NDRC on Relevant Issues Relating to Foreign-invested Equity Investment Enterprises* on April, 2012, the NDRC affirms that RMB funds in the form of a limited liability partnership with a foreign-invested company as general partner ("GP") and with only PRC domestic investors as limited partners ("LPs") shall still be deemed as foreign investors, and their portfolio investments are therefore subject to the *Catalogue of Industries for Guiding Foreign Investment*. However, such breakthrough still has a considerable amount of uncertainty.

We will keep a close eye on any breakthroughs and innovations in the Shenzhen QFLP program that are supportive of the pioneering policies in Qianhai.

Below are the key points of the Interim Measures:

1. Competent Authority

A pilot program leading group (the "**Leading Group**") of foreign-funded equity investment enterprises consisting of the Shenzhen Financial Services Office, Shenzhen Economy, Trade, and Information Commission, Shenzhen Market Supervision Administration, Qianhai

¹ Shanghai Financial Services Office, Shanghai Municipal Commission of Commerce and Shanghai Administration for Industry & Commerce jointly promulgated *The Implementation Measures for the Launching of a Pilot Program for Foreign-funded Equity Investment Enterprises in Shanghai* on December 24, 2010, Article 24 of which provides that the foreign-funded equity investment management enterprises that have been approved to participate in the pilot program may use foreign exchange funds as capital contribution to the equity investment enterprises sponsored and established by such enterprises, provided that the amount shall not exceed 5% of total funds raised. The said portion of capital contribution shall not affect the original type of the invested equity investment enterprise.

Administration Bureau, Shenzhen Development and Reform Commission, and the People's Bank of China Shenzhen Central Sub-branch is responsible for the following duties: accepting applications, examination and approval, record-filing and managing foreign-funded equity investment enterprises and foreign-funded equity investment management enterprises (collectively, the "**Pilot Enterprises**"), as well as accepting the applications and examination of pilot custodian banks, and formulating and implementing the relevant supportive policies.

2. Application Scope

According to the Interim Measures, the pilot program will be the first implemented in Qianhai to increase financial cooperation between Shenzhen and Hong Kong and promote the innovative development of equity investment fund industries in Qianhai, and gradually be implemented in all of Shenzhen's districts in the future. However, the Interim Measures do not state the specific time of implementation in all districts of Shenzhen.

3. Registered Capital

- 1) For a foreign-funded equity investment enterprise: the subscribed capital contribution shall not be less than USD15 million or the equivalent with capital contributions to be made in cash only; except for general partners, the capital contributions of each of the other limited partners shall not be less than USD1 million or the equivalent.
- 2) For a foreign-funded equity investment management enterprise: the registered capital (or subscribed capital contribution) shall not be less than USD 2 million or the equivalent, with capital contributions to be made in cash only.
- 3) Time of Contribution: at least 20% of the registered capital (or subscribed capital contribution) shall be in place within three months of the issuance date of the business license, with the balance to be paid up within two years.

4. Senior Management Personnel

A foreign-funded equity investment management enterprise shall have at least two senior management personnel who shall both meet with the requirements provided in Article 7 of the Interim Measures, which are listed in the following points:

- five or more years practical experience in equity investment or equity investment management activities;
- two or more years experiences in senior management duties;
- experience in the practice of China-related equity investment or practical experience in a financial institution in China;

- have no record of violating Chinese laws or regulations, nor pending economic dispute lawsuits in the most recent five years; and
- have a positive personal credit record and etc.

5. Foreign Investor Requirements

Foreign investors of Pilot Enterprises applying to be under the pilot program shall possess sound governance structures and comprehensive internal control systems without having penalties imposed by judicial authorities and relevant supervisory authorities in the most recent two years. Foreign investors or affiliated entities thereof shall have relevant investment experience, and the investors shall be primarily formed by foreign sovereign wealth funds, retirement funds, endowment funds, charity funds, fund of funds (FOF), insurance companies, banks, securities companies, as well as any other foreign institutional investors approved by the Leading Group.

6. Name

Pilot Enterprises examined and approved by the Leading Group may indicate in their names through the wordings "equity investment fund" or "equity investment fund management".

7. Fund Sources

The contributions of foreign investors in cash shall be in the form of: (i) freely convertible currency, (ii) overseas RMB, (iii) the RMB profits obtained within the territory of Mainland China thereof, or (iv) legal gains in RMB obtained as a result of activities such as share swaps or liquidation. Capital contributions by Chinese investors shall be made in RMB.

8. Fund Custodian

Pilot Enterprises shall authorize a bank registered in Shenzhen that satisfies the requirements to be the fund custodian. The custodian bank shall bear the responsibility of submitting regular reports to the Leading Group on information such as the operating conditions of entrusted funds, and investment projects, as well as the domestic equity investment conditions of Pilot Enterprises.

9. Establishment, Change, and Record-filing

- 1) Establishment: a Pilot Enterprise applying to be under the trial program shall submit a pilot application to the Shenzhen Financial Services Office through the executive partner of the equity investment enterprise intended to be established. After the preliminary examination, the Shenzhen Financial Services Office will submit the application to the Leading Group for examination and approval.

- 2) Change: the Shenzhen Market Supervision Administration shall seek the opinion of the Shenzhen Financial Services Office when a Pilot Enterprise changes its business scope, partners, the amount of subscribed or paid-up capital contribution, payment deadline of the subscription or payment, or type of the partnership enterprise.
- 3) Record-filing: a Pilot Enterprise shall submit a report to the Shenzhen Financial Services Office every six months regarding major events that have occurred in the course of its investment operation during the previous half of the year, such as: investments made by the Pilot Enterprise, changes in senior management personnel, the management enterprise, and the registered capital (subscribed capital contribution), divisions or mergers, dissolution, liquidation or bankruptcy, etc.

Important Announcement

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