

# Legal Commentary

February 10, 2021

## Private Equity Law

### Analysis of New Shenzhen QFLP Scheme

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On 29 January 2021, the Shenzhen Municipal Financial Regulatory Bureau (“**Shenzhen FRB**”) released the *Measures for the Pilot Program of Foreign-invested Equity Investment Enterprises in Shenzhen* (hereinafter referred to as the “**New Shenzhen QFLP Scheme**”), which is implemented beginning 8 February 2021 and will remain effective for the next three years. Upon its coming into force, the *Measures for the Pilot Program of Foreign-invested Equity Investment Enterprises in Shenzhen* enacted in September 2017 by Shenzhen FRB (Shen Jin Gui [2017] No.1) (the “**Previous Shenzhen QFLP Scheme**”) has been repealed.

The New Shenzhen QFLP Scheme has been adopted in light of the general principle of establishing national treatment for QFLPs while taking into account their “foreign invested + private equity” nature as well as requirements of the latest laws, regulations and regulatory policies relating to foreign investment and private equity. The changes in the New Shenzhen QFLP Scheme over the Previous Shenzhen QFLP Scheme are quite “revolutionary” as compared to the relatively minor changes proposed in the *Measures for the Pilot Program of Foreign-invested Equity Investment Enterprise in Shenzhen (Draft for Comment)*, released by Shenzhen FRB on 26 October 2020.

To analyze Shenzhen’s QFLP policies both current and future and across jurisdictions, this article is divided into two parts. Part I of this article summarizes and comments on the substantial changes implemented by the New Shenzhen QFLP Scheme relative to the Previous Shenzhen QFLP Scheme.

Part II of this article compares key elements of the New Shenzhen QFLP Scheme side-by-side with those of QFLP schemes of Zhuhai City and Hainan Province, which are also located in South China.

### Comparison of policies before and after release of the New Shenzhen QFLP Scheme

Innovative changes brought by the New Shenzhen QFLP Scheme mainly include the following:

1. Foreign-invested equity investment enterprises (“**QFLP Funds**”) are no longer limited to directly investing in industrial projects. QFLP Funds are now permitted to invest as funds of funds (FOFs) in other domestic private equity and venture capital funds, while the underlying funds of QFLP Funds are

encouraged to invest directly in industrial enterprises. Simply judging from the wording of the document, it will be practicable for QFLP Funds to invest in other private funds in the form of FOFs, although the actual feasibility of this structure awaits verification in scheme to be implemented later. We will monitor the administrative review practices for Shenzhen QFLP Fund's investments in other private funds and/or special purpose vehicles (SPVs) and share with you the most up-to-date experiences and information we obtain;

2. It is specified that QFLP Funds are permitted to acquire ordinary shares of listed companies through non-public offerings and transactions including but not limited to private placements, block trades, negotiated transfers, and participation in share allotments as the existing shareholders of the listed companies;
3. Previous requirements are repealed for foreign-invested equity investment management companies ("**QFLP Managers**"), including those regarding registered capital amount or capital commitment, schedules of capital contribution, investors, professionals, the time limit for completion of fund manager registrations and the formation and registration of private funds, QFLP Fund capital commitment, QFLP Fund investors, the special requirement to unify the QFLP Manager and general partner, and QFLP Managers and QFLP Funds will only be required to comply with laws and regulations applicable to ordinary domestic private funds and the private fund managers in these aspects.

Despite all these welcome changes, it should be noted that the New Shenzhen QFLP Scheme in principle continues to require QFLP Managers to be registered in Shenzhen. Moreover, it is uncertain that whether general partners will also be required to be registered in Shenzhen where the general partner and the QFLP Manager are separate persons as permitted by the New Shenzhen QFLP Scheme. Some other cities have already enacted QFLP schemes that do not mandate the fund management company and/or general partner to be locally incorporated and registered. We look forward in this regard to further specific opening-up measures taken by the local Shenzhen authorities.

To be specific, the New Shenzhen QFLP Scheme introduces changes mainly in the following three aspects:

#### **I Adjusting the supervisory structure to increase review efficiency**

The "leading group + pilot program office" supervisory structure is replaced by a joint consulting mechanism between Shenzhen FRB and other related authorities, including Development and Reforming Commission of Shenzhen Municipality, so as to increase efficiency in reviewing QFLP applications. In addition, administrative authority is delegated to the Qianhai Financial Regulatory Bureau for QFLP scheme in Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone and China (Guangdong) Pilot Free Trade Zone Qianhai and Shekou Area of Shenzhen. Provisions under the Previous Shenzhen QFLP Scheme regarding specific application procedures and application documents are deleted by New Shenzhen QFLP Scheme. We may reasonably expect Shenzhen FRB to specify the application procedures in future implementing rules or guidance. However, the possibility still exists that such implementing rules or guidance may adopt certain access thresholds for the actual review process.

## **II Lowering QFLP Manager access thresholds and removing several requirements for QFLP Manager management and operations**

1. The following special requirements for QFLP Managers and their investors, professionals are repealed and QFLP Managers will instead be governed by the requirements of the Asset Management Association of China (“**AMAC**”) applicable to the registration of ordinary private fund managers:
  - Requirements for minimum registered capital/capital commitment;
  - Time limit for contribution of registered capital/capital commitment;
  - Requirements regarding status, net assets, assets under management, and investor qualifications;
  - Professional experience requirements for senior management;
  - Time limit for setting up new private funds after obtaining a private fund management company qualification.
2. The mandatory custody requirements for the QFLP Funds are repealed;
3. The prohibition is lifted on QFLP Managers making direct investments.

## **III Lowering QFLP Fund formation thresholds and removing several requirements for QFLP Fund management and operations**

1. The following special requirements are repealed for QFLP Funds and their investors. QFLP Funds will instead be subject to requirements applicable to ordinary private funds in the following aspects:
  - Requirements for minimum registered capital/capital commitment;
  - Requirements for the net assets and minimum capital commitment in QFLP Funds of offshore institutional investors (i.e. we understand in this regard that, post implementation, QFLP Funds will be subject to the requirements for qualified investors of ordinary domestic private funds).
2. The restriction is repealed that the actual controller of the general partner of a QFLP Fund cannot directly and/or indirectly hold more than 50% of the interests of a QFLP Fund. As many QFLP Funds had difficulty complying with this restriction when considering fundraising through accepting offshore funds promoted by their respective QFLP Manager or its affiliates as limited partners, the removal of this restriction undoubtedly provides QFLP Funds with greater flexibility in their overall structures.
3. QFLP Managers must still be an entity registered in Shenzhen in principle. However, the general partner and the management company of QFLP Funds in the form of limited partnership are no longer required to be the same entity, and the New Shenzhen QFLP Scheme also permits co-general-partners structures. Moreover, the New Shenzhen QFLP Scheme provides that permitted management approaches for QFLP Funds include QFLP Funds managed by QFLP Managers, domestic funds managed by QFLP Managers, and QFLP Funds managed by domestic management companies. Such modifications have been adopted in due consideration of the demands of the private fund market in recent years and to enable QFLP Fund structures to be more flexibly designed and diversified.

4. The requirement is repealed regarding the level of custodian banks.
5. The prohibition is lifted on QFLP Fund investments in other private equity or venture capital funds. In practice, we find that there have already been QFLP Funds set up in Shenzhen that adopted the FOF structure before the release of the New Shenzhen QFLP Scheme, which is absolutely good news for FOFs and secondary funds.
6. The special time limit is removed for QFLP Fund formation and private fund product registration.

#### IV Enhancing interim and post-event supervision

It is specified that Shenzhen FRB and other related authorities will introduce QFLP Managers, QFLP Funds and custodian banks into the Shenzhen private fund information service platform to file their data and information. This measure is taken in consideration of the common practice that custodian banks largely monitor QFLP Fund operations. The newly established information filing obligations for QFLP Funds will enable Shenzhen FRB to carry out interim and post-event supervision more effectively.

### Side-by-side comparison of New Shenzhen QFLP Scheme with QFLP schemes in Zhuhai City and Hainan Province

Talk of Shenzhen naturally brings to mind its neighboring city, Zhuhai, once a hot choice for private funds, and Hainan Province, currently the most popular choice for private funds in South China, especially given that Zhuhai and Hainan Province released their local QFLP policies in January 2019 and October 2020, respectively, the *Interim Measures for Administration of the Pilot Scheme for Foreign-invested Equity Investment Enterprises in Zhuhai* (the “**Zhuhai QFLP Scheme**”) and *Interim Measures for the Implementation of Qualified Foreign Limited Partner (QFLP) Inbound Equity Investment in Hainan Province* (the “**Hainan QFLP Scheme**”). The Hainan QFLP Scheme, which is the most recently enacted among the three locations, is noticeably superior given its flexibility. This table below outlines differences of key requirements among these three QFLP schemes:

| #                                   | Shenzhen QFLP   | Hainan QFLP  | Zhuhai QFLP   |
|-------------------------------------|---|--|---|
| <b>Governing Authorities</b>        | Governed by the joint consulting mechanism between Shenzhen FRB and other authorities including Development and Reform Commission of Shenzhen Municipality. The liaison office is maintained by Shenzhen FRB. | Governed by the financial regulatory administration jointly with Administration for Market Regulation, China Securities Regulatory Commission (the “ <b>CSRC</b> ”), The People’s Bank of China Haikou Central Sub-branch and other authorities. | Governed by the leading group of the Zhuhai Municipal Government.   |
| <b>Registered Place of Business</b> | <b>QFLP Manager:</b> in principle must be registered in Shenzhen;<br><b>GP:</b> not specified;<br><b>QFLP Fund:</b> must be   | <b>QFLP Manager:</b> in principle must be registered in Hainan;<br><b>GP:</b> not specified;<br><b>QFLP Fund:</b> must be registered in Hainan.  | <b>QFLP Manager:</b> must be registered in Zhuhai;<br><b>GP:</b> must be registered in Zhuhai in principle while may be registered in other places subject to approval in |

| #  | Shenzhen QFLP   | Hainan QFLP   | Zhuhai QFLP  |
|--|---|---|--|
|  | registered in Shenzhen.   |   | the event that general partner is separate from management company;<br><b>QFLP Fund:</b> must be registered in Zhuhai.   |
| <b>Registered Capital/Capital Commitment of QDLP Manager</b> | Requirements applicable to ordinary domestic private fund managers must be satisfied. | Requirements applicable to ordinary domestic private fund managers must be satisfied. | No less than USD 2 million or its equivalent in other currencies with more than 20% of the capital contributed within 3 months from the issuing of the business license, and the remainder contributed within 2 years following the set-up of the enterprise.  |
| <b>Investors of QFLP Manager</b>                             | Requirements applicable to ordinary domestic private fund managers must be satisfied. | Requirements applicable to ordinary domestic private fund managers must be satisfied. | <ul style="list-style-type: none"> <li>■ Hong Kong or Macao investor with NAV of no less than USD 6 million or asset under its management of no less than USD 12 million or its equivalent in other currencies in the previous fiscal year; other foreign investor with NAV of no less than USD 100 million or assets under management of no less than USD 200 million or its equivalent in other currencies in the previous fiscal year; or foreign investor who has obtained asset management license issued by foreign financial administration;</li> <li>■ Domestic investors shall be entities with asset management license or subsidiary with more than 50% of its capital controlled by such entity, or Zhuhai enterprise with NAV of no less than RMB 300 million or asset under management of no less than RMB 500 million in the previous fiscal year, or Zhuhai enterprise with a total net profit of the last three years of no less than RMB 60 million and total tax payment of no less than RMB 18 million, or Zhuhai enterprise listed on domestic or overseas main board market or its controlling shareholder.</li> </ul> |

| #                                      | Shenzhen QFLP  | Hainan QFLP  | Zhuhai QFLP  |
|--|--|--|--|
| <b>Professionals</b>                   | Requirements applicable to ordinary domestic private fund managers must be satisfied.                              | Has at least 2 senior management personnel satisfying all the requirements as follows: <ul style="list-style-type: none"> <li>■ Has at least five years of experience in equity investment or equity investing management;</li> <li>■ Has at least two years of senior management work experience;</li> <li>■ Has equity investment experience in China or experience working at domestic financial institutions;</li> <li>■ Has no record of violating any law or regulation within the last five years or pending financial dispute litigation, and has a good credit record.</li> </ul> | The same as Hainan.  |
| <b>QFLP Fund Structure</b>             | General partners and management companies may be separate persons, and co-general-partners structures are allowed. | There is no need for general partner and management company to be the same.  | General partner and management company should be the same in principle. However, the general partner and management company may be different persons, subject to approval in practice.   |
| <b>Capital Commitment of QFLP Fund</b> | /  | /  | <ul style="list-style-type: none"> <li>■ QFLP Funds set up by Hong Kong and Macao enterprises or individuals must commit a capital no less than USD 6 million or its equivalent in other currencies;</li> <li>■ QFLP Funds set up by other offshore enterprises or individuals must commit a capital no less than USD 15 million or its equivalent in other currencies.</li> </ul> |
| <b>QFLP Fund Investors</b>             | Requirements applicable to ordinary domestic private fund investors must be satisfied.                             | Requirements applicable to ordinary domestic private fund investors must be satisfied.   | In the event that the general partner and certain limited partners share the same actual controller, such actual controller must not invest in more than 50% of the interests of the QFLP Fund.  |

| #   | Shenzhen QFLP  | Hainan QFLP  | Zhuhai QFLP  |
|---|--|--|--|
| <p><b>QFLP Fund Investment Restrictions</b></p> | <ul style="list-style-type: none"> <li>■ Can invest in non-listed company equities;</li> <li>■ Can invest in domestic private equity funds and venture capital funds, while such underlying funds invested in by QFLP Funds are encouraged to directly invest in industrial enterprises;</li> <li>■ Can invest in non-publicly offered and traded ordinary shares of listed companies, including shares offered through private placements, block trades, negotiated transfers, etc.;</li> <li>■ Can participate in share allotments as the existing shareholders of listed company;</li> <li>■ Can invest in other forms as permitted by CSRC or AMAC.</li> </ul> | <p>The following activities are prohibited:</p> <ul style="list-style-type: none"> <li>■ Invest in industries prohibited to foreign investment;</li> <li>■ Invest in secondary market stocks and corporate bonds, except for investment targets otherwise approved by the Hainan Provincial Financial Regulatory Bureau, CSRC Hainan Provincial Administration, the People's Bank of China Haikou Central Sub-branch, Hainan Provincial Administration for Market Regulation.</li> <li>■ Participate in futures and other financial derivative trading;</li> <li>■ Invest in non-self-use real estate;</li> <li>■ Divert non-proprietary funds into investments;</li> <li>■ Provide loan or guarantee to non-invested entities;</li> <li>■ Other activities prohibited by laws and regulations.</li> </ul> | <p>Investment as FOFs is prohibited, except for cases where the QFLP involves municipal or higher level strategic cooperation or the investment is directed toward a specific industrial project through a project fund.</p>   |
| <p><b>Preferential Policies</b></p>             | <p><i>Several Measures Supporting the Development of Financial Industry of Shenzhen</i> provides settlement rewards, rewards based on managed asset scale, management fee income rewards, office purchasing or rental subsidies, and supporting policies for introduced key super large equity investment enterprises.</p>   | <ul style="list-style-type: none"> <li>■ Equity investment fund management professionals may apply for the accreditation of high-level talents of Hainan Province pursuant to applicable policies. Those who satisfy the conditions can enjoy preferential policies regarding residence, home and vehicle purchases, spousal employment, children's education, medical and housing guarantees.</li> <li>■ Each city's (county's) government or management commission of key industrial park shall enact QFLP supporting policies including</li> </ul>  | <p>The QFLP Funds and management companies registered in Zhuhai Hengqin New Area can enjoy support policies for settlement and business operations under the <i>Measures for Supporting further Promotion and Development of Private Equity Investment Fund Industry in Hengqin New Area</i>. QFLP Management Company registered in other area of Zhuhai can enjoy preferential policies including:</p> <ul style="list-style-type: none"> <li>■ For QFLP Managers (which must be registered in Zhuhai): 100% return of local retained part of its tax payment.</li> <li>■ For investors of QFLP Funds and senior management: tax refunds based on different percentages depending on total taxes paid.</li> </ul> |

| # | Shenzhen QFLP | Hainan QFLP   | Zhuhai QFLP |
|---|---------------|---|-------------|
|   |               | <p>settlement rewards, office housing rewards, economic contribution rewards, etc.</p> <ul style="list-style-type: none"> <li data-bbox="671 409 1002 864">■ Hainan Provincial Financial Regulatory Bureau, CSRC Hainan Provincial Administration and the municipal level administration for market regulation shall promote private equity transactions, maximize the platform functions of each trading venue, and support custody, transactions and withdrawals of QFLP enterprises.</li> <li data-bbox="671 880 1002 1037">■ QFLP enterprises in good standing may be eligible for more convenient foreign exchange management measures.</li> <li data-bbox="671 1052 1002 1507">■ Enterprises in encouraged industries registered in and running their business in Hainan Province are eligible for the preferential enterprise income tax rate of 15%; high-level talents and urgently-needed talents working in Hainan Free Trade Port are eligible for an exemption from personal income taxes to the extent the actual tax burden exceeds 15%;</li> <li data-bbox="671 1523 1002 2040">■ Depending on the registered place of business of the QFLP Fund or QFLP Manager, different regions, fund towns, industrial parks may provide preferential tax policies or rewards based on the specific circumstances of the QFLP Fund. According to current practices, there are chances for QFLP Funds and its QFLP Manager to obtain an actual tax rate as low as 10%.</li> </ul> |             |



The New Shenzhen QFLP Scheme takes the first step to promote the constant and high-quality development of equity investment activities in Shenzhen<sup>1</sup>, which sufficiently reflects the spirit of the Fifth Plenary Session of the 19th Central Committee of the Communist Party of China and requirements of “private equity and venture capital market access and developing environment optimization” raised by President Xi Jinping in his important speech in the Celebration of the 40th Anniversary of the Establishment of Shenzhen Special Economic Zone toward the comprehensive reform pilot program in Shenzhen. It may be reasonably anticipated that Shenzhen will later enact further polices and measures to realize the optimization of private equity and venture capital markets following the first steps in cross-border policy reform and perfection in Shenzhen taken by the New Shenzhen QFLP Scheme. We also expect such policies and measures will complement each other together with the New Shenzhen QFLP Scheme so as to highlight Shenzhen’s unique attractiveness as a pioneer in reform and opening-up.

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<sup>1</sup> Shenzhen FRB specified in *Several Measures regarding the Promotion of Constant and High-Quality Development of Equity Investment Activities in Shenzhen (Draft for Comment)* dated 8 January 2021 that “[e]xpanding the scale of foreign invested equity investment enterprise (QFLP) pilot program, reasonably expanding the scope of equity investment, lowering the access threshold for qualified investors. Deepening pilot program of qualified domestic limited partners (QDIE), promoting outbound investment facilitation.”

## ***Important Announcement***

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