Newsletter

11th Edition of 2011

Insights & Ideas

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

Legal Updates

1. Brief of Circular of the Ministry of Commerce and the State Administration of Foreign Exchange on Further Improving the Administration Measures Concerning Foreign-funded Investment Companies
2. HKEx Updated Listing Decision on Contractual Arrangements
3. Introduction to Tianjin QFLP Interim Measures and Its Implementing Rules

NDRC Expanding Mandatory Record-filing Requirements for Private Equity Funds to Nationwide (Authors: James WANG; Evan ZHANG, Maggie TAN, Lu RAN)

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' 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.

Legal Updates

1. **Brief of Circular of the Ministry of Commerce and the State Administration of Foreign Exchange on Further Improving the Administration Measures Concerning Foreign-funded Investment Companies (Authors: Bing XUE; Qi LUO)**

On December 8, 2011, the Ministry of Commerce ("MOFCOM") and the State Administration of Foreign Exchange ("SAFE") jointly issued *the Circular of the Ministry of Commerce and the State Administration of Foreign Exchange on Further Improving the Administration Measures Concerning Foreign-funded Investment Companies* (Shang Zi Han [2011] No.1078, "Circular No.1078") to further clarify the regulations on the examination and approval and foreign exchange management of foreign-funded investment companies.

We set forth below salient points regarding domestic reinvestment of foreign-funded investment company arising from Circular No.1078.

1) Background of Regulations on Foreign-funded Investment Company

In order to facilitate foreign investment in China, in 2004, the MOFCOM issued *the Provisions on the Establishment of Foreign-funded Investment Companies* (Decree No.22 [2004] of the MOFCOM); then in 2006, the MOFCOM issued *the Supplementary Provisions on the Establishment of Foreign-funded Investment Companies* (Decree No.3 [2006] of the MOFCOM, "Decree No.3") to further improve relevant policies regarding the establishment of foreign-funded investment companies.

2) Domestic Reinvestment by Foreign-funded Investment Company

Pursuant to Decree No.3, where a foreign investor makes a contribution to the registered capital (or capital increase) of a foreign-funded investment company with the Renminbi profit gained in China or with the legitimate Renminbi gains derived from the activities such as equity transfer and liquidation, the foreign-funded investment company may use the entire or part of such share of capital contribution for domestic investment to establish an enterprise.

On March 29, 2011, Capital Account Management Department of the SAFE issued *the Notice of the Capital Account Management Department of the State Administration Of Foreign Exchange on Operation Guidelines for Issues Concerning Capital Verification Inquiry Into Foreign-funded Investment Companies' Reinvestment* (Hui Zi Han [2011] No.7, "Notice No.7") to further clarify the procedures in relation to approval of domestic investment of foreign-funded investment companies and capital verification inquiry into foreign-funded investment companies. According to Notice No.7, a foreign-funded investment company shall covert its domestic legitimate

Renminbi gains into capital increase before it may make any reinvestment into domestic enterprise with such legitimate Renmenbi gains, which is consistent with the rules contained in Decree No.3. However, this seemingly clear requirement leaves another ambiguity: Is capital increase the only approach for a foreign-funded investment company to make reinvestment into domestic enterprise with its domestic legitimate gains?

The issuance of Circular No.1078 clarifies the said ambiguity. Besides capital increase, foreign-funded investment companies may adopt another approach for reinvestment: a foreign-funded investment company may directly use its Renminbi profit gained in China, Renminbi legitimate gains from advance investment recovery, liquidation, equity transfer and capital reduction for domestic investment upon approval by the local foreign exchange bureau. Such provision in Circular No.1078 is definitely good news for those foreign investors that intend to establish foreign-funded investment companies in China recently.

3) Limitations on Use of Domestic Loans by Foreign-funded Investment Company

Circular No.1078 stresses that no domestic loans of foreign-funded investment companies shall be used for domestic reinvestment. Actually, *General Rules of Loans* issued by the People's Bank of China (Decree No.2 [1006] of the People's Bank of China) in 1996, explicitly states that borrowers shall not use the loan for equity investment activities in share capital.

4) The Examination and Approval Procedure and Documentary Requirements for Direct Domestic Investment by Foreign-funded Investment Company

According to Circular No.1078, a foreign-funded investment company shall submit the following documents to the in-charge foreign exchange bureau for the reinvestment:

- A written application;
- Foreign Exchange Registration IC Card;
- The approval documents issued by the competent commerce bureau in respect of the domestic investment of foreign-funded investment company;
- Evidentiary materials of Renminbi fund sources, which shall refer to the documents submitted by foreign-invested enterprise for the reinvestment (capital increase) by use of the gained profit, the income from advance investment recovery, liquidation, equity transfer and capital reduction; and
- The latest capital verification report and auditors' report on financial matters (with the audit report on the corresponding foreign exchange income and expenditure attached).

After the local foreign exchange bureau has examined and verified the above documents and issued the approval document, the foreign-funded investment company may directly transfer the

corresponding Renminbi funds to the invested enterprise, or firstly transfer them to the foreign-funded investment company and subsequently to the invested enterprise.

5) Enhancement on the Verification and Administration of Examination and Approval Statistics Information of Foreign-funded Investment Company

In addition, Circular No.1078 requires that the competent commerce bureau at all levels shall strengthen the verification and administration of examination and approval statistics information of foreign-funded investment companies. Any foreign investment company, if its establishment is approved, is required to be marked as the "Investment Company" on the Foreign-invested Enterprises' Basic Information Form and shall be entered into the examination and approval administration system of foreign-invested enterprises of the MOFCOM. And any enterprise in any other form shall not be marked as “Investment Company”, “Investment Holding” or similar names; such marks will be the key matters of annual joint inspection on foreign-invested enterprises

2. HKEx Updated Listing Decision on Contractual Arrangements (Author: Taoran WANG)

In 2005, the Hong Kong Exchanges and Clearing Limited (the “**HKEx**”) issued a listing decision (cited as HKEx-LD43-3) regarding a listing applicant incorporated outside Hong Kong (the “**Applicant**”), which controls an entity that is incorporated inside China (“**OPCO**”) to actually run the business via contractual arrangements. According to the decision, the HKEx, while adopting a disclosure-based regulatory approach, determined that in principle, the contractual agreements would not render the Applicant unsuitable for listing, as long as the financial results of the OPCO can be consolidated into the Applicant’s and the Applicant and its business satisfy all conditions for listing [1] under the Listing Rules.

In November 2011, the HKEx adopted an amendment to the foregoing listing decision (the “**Amendment**”), confirming that in principle, when assessing the listing application submitted by the relevant Applicant, the HKEx will give full consideration of the reasons for adopting the contractual arrangements and will “allow such arrangements on a case-by-case basis”, should the Applicant satisfy other conditions in the listing decision. If the business in relation to the contractual arrangements doesn’t fall into the scope of the industry sectors where applicable PRC regulations limit foreign investment, the Listing Division will normally refer the case to the Listing Committee. Meanwhile, This Amendment, based on the existing regulations in relation to the listing decisions, added the following specific requirements and limitations on the listing applications submitted by the Applicants adopting contractual arrangements.

Compulsory Disclosure of the Reasons for Adopting the Contractual Arrangements

The Amendment expressly requires the Applicant and its sponsor to disclose to the HKEx and explain the reason for adopting contractual arrangements in its business operation.

Limitation on the Adoption of Contractual Arrangements

The Amendment sets forth limitations on the Applicant's adoption of contractual arrangements, requesting the Applicant to unwind the contractual arrangements as soon as the law allows the business to be operated without them. In other words, the Applicant will not be allowed to use contractual arrangements if the business run by the Applicant doesn't fall into the scope of industry sectors where foreign investment is restricted by PRC regulations.

Ensuring the Implementation of Contractual Arrangements

To ensure the proper implementation of contractual arrangements adopted by the Applicants, the Amendment includes the following provisions:

1) Power of attorney granted by OPCO's shareholders to the Applicant's directors and their successors. The Amendment provides that the Applicant and its sponsor should submit a power of attorney by which the OPCO's shareholders grant to the Applicant's directors and their successors (including a liquidator replacing the Applicant's directors) the power to exercise all rights of the OPCO's shareholders, including, among others, the rights to vote in a shareholders' meeting, sign minutes, file documents with the relevant companies registry;

2) Adding dispute resolution clauses in compliance with the HKEx's requirements. The Amendment requests the Applicant to enter into an arbitration clause with the OPCO, under which "the arbitrators may award remedies over the shares or land assets of OPCO, injunctive relief (e.g. for the conduct of business or to compel the transfer of assets) or order the winding up of OPCO". Meanwhile, the arbitration clause should provide the courts of Hong Kong, the Applicant's place of incorporation, the OPCO's place of incorporation, and the place where the Applicant or the OPCO's principal assets are located, to have the competent jurisdictions to the effect that such courts are empowered to grant interim remedies in support of the arbitration, pending formation of the arbitral tribunal or in appropriate cases; and

3) The Applicant shall be entitled to deal with the OPCO's assets. The Amendment requests that the Applicant should be granted not only the right to manage the OPCO's business and the right to the OPCO's revenue, but also the right to deal with the OPCO's assets. This is

to ensure that the liquidator, acting on the contractual arrangements, can seize the OPCO's assets in a winding up situation for the benefit of the Applicant's shareholders or creditors.

Footnotes:

[1] If, based on the main facts and the PRC legal opinion submitted by the Applicant, the HKEx determines that the Applicant has proved the legitimacy of the contractual arrangements and that the Applicant has the ability to ensure the sound and proper operation of the contractual arrangements, the HKEx would then determine the Applicant and its business are suitable for listing as long as the Applicant fully discloses the contractual arrangements and associated risks in the prospectus.

3. Introduction to Tianjin QFLP Interim Measures and Its Implementing Rules (Authors: James WANG, Evan ZHANG, Kelvin GAO, Vincent SONG and Florine GU)

After the Shanghai and Beijing Municipal Governments successively promulgated the rules for pilot foreign-invested equity investment enterprises, Tianjin Development and Reform Commission ("**Tianjin DRC**"), Financial Affairs Office of Tianjin Municipal People's Government, Tianjin Commission of Commerce and Tianjin Administration for Industry and Commerce jointly issued the *Interim Measures on Carrying out the Pilot Program for Foreign-Invested Equity Investment Enterprises and Management Enterprises* in Tianjin (the "**Tianjin QFLP Measures**") and *the Implementing Rules on the Interim Measures on Carrying out the Pilot Program for Foreign-Invested Equity Investment Enterprises and Management Enterprises in Tianjin* (the "**Implementing Rules**") on October 14, 2011. The Tianjin QFLP Measures will come into force as of the date of promulgation, while the Implementing Rules will take effect 30 days thereafter.

The Tianjin QFLP Measures and the Implementing Rules mainly regulate the establishment, fundraising and downstream investment, risk control, information disclosure and filing for foreign-invested equity investment funds and foreign-invested fund management enterprises. The Tianjin QFLP Measures and the Implementing Rules were generally modeled after the QFLP measures issued in Shanghai and Beijing, with some differences with respect to foreign exchange settlement, qualifications for pilot equity investment management enterprises and other aspects.

Competent Governmental Authority for the Pilot Program

Tianjin Municipal Office for Development of Industry (Equity) Investment Funds and Administration of Filing (the "**Municipal Filing Office**"), which consists of Tianjin DRC, Tianjin Commission of Commerce, the Municipal Financial Office, Tianjin Administration for Industry and Commerce, Tianjin Municipal Finance Bureau, Tianjin Tax Bureau, Tianjin Banking Regulatory Bureau and Tianjin Private Equity Association, is the competent governmental authority for

administering the Pilot Program. A pilot enterprise will be recognized upon the approvals by the Municipal Filing Office and leaders of Tianjin Municipal Government.

Recognition of Pilot Enterprises

The pilot enterprises refer to foreign-invested equity investment enterprises and foreign-invested management enterprises as recognized by the Municipal Filing Office, which will generally take two procedures (i.e., examination and approval).

Examination Equity investment enterprises and management enterprises applying for the pilot program shall submit relevant materials through the equity investment management enterprises to Tianjin DRC, who shall call the members of the Municipal Filing Office to review the application, which is expected to be finished within ten (10) business days upon receipt of the complete application documents.

Approval Equity investment enterprises and management enterprises passing the examination shall submit relevant materials through the equity investment management enterprises to Tianjin DRC, who shall convene the members of the Municipal Filing Office to review the qualifications for the pilot program and the foreign exchange settlement quota within ten (10) business days upon receipt of the complete application documents. Enterprises qualified for the pilot program after the review process shall be reported by Tianjin DRC to competent municipal leaders for approval, and Tianjin DRC shall issued verification documents to the applying enterprises after such approval.

Qualifications for Pilot Enterprises

Qualifications for Pilot Foreign-Invested Equity Investment Management Enterprises According to the Tianjin QFLP Measures and the Implementing Rules, qualifications for a pilot equity investment management enterprise include that the following:

1) the business scope stipulated in the articles of association or the partnership agreement shall be limited to establishment of equity investment enterprises, management of the assets of equity investment enterprises, provision of management services for portfolios of equity investment enterprises, equity investment consultation, or other activities related to equity investment;

2) the paid-in capital shall be no less than RMB10 million or equivalent amount of foreign currency;

3) it has at least two (2) senior management personnel satisfying all of the following requirements: (*A*) more than five (5) years of experience in the business of equity investment or equity investment management; (*B*) more than two (2) years of experience in a position of senior management; (*C*) experience in China-related equity investment or work experience in Chinese financial institutions; (*D*) no record of violation of laws and regulations within the recent five (5) years or pending economic disputes, plus a record of good personal credit;

4) it has law/rule-compliant operation, strict and reasonable investment decision procedures and risk control system;

5) it has a sound internal finance management system and accounting measures in accordance with applicable finance and accounting rules; and

6) the equity investment enterprises to be raised or managed by it shall primarily invest in the new industries preferentially developed in Tianjin (Unlike Beijing, *Tianjin does not enumerate the specific industries. Based on our telephone inquiry on a no name basis, the official of Tianjin DRC indicated that there is no specific industry investment restriction, but applications from the equity investment enterprises that can demonstrate a pipeline of projects in Tianjin will be preferred*).

It is noteworthy that the paid-in capital of equity investment management enterprises participating in the pilot program shall be no less than RMB10 million or equivalent amount of foreign currency. In comparison, the registered capital requirement for the pilot management enterprises to be established in Shanghai is no less than USD2 million, while no clear requirement has been set forth in Beijing. The Tianjin QFLP Measures further require that the pilot equity investment management enterprises shall have certain senior Chinese management personnel, while no similar requirements were provided in Beijing QFLP measures or Shanghai QFLP measures.

Qualifications for Pilot Foreign-Invested Equity Investment Enterprises According to the Tianjin QFLP Measures and the Implementing Rules, qualifications for a pilot foreign-invested equity investment enterprise include that the following:

1) it may consist solely of foreign capital raised offshore, or partially of RMB funds raised onshore and partially of foreign capital raised offshore, and the total size of the fund shall in principle be no less than RMB500 million or equivalent amount of foreign currency. The equity investment management enterprise can subscribe for certain percentage (no more than 5%) of the investors' total capital commitments to the fund;

2) its management enterprise shall be qualified as a pilot equity investment management enterprise as set forth above; and

3) its offshore investors shall meet the following requirements: (*A*) during the preceding fiscal year, its own assets shall be no less than USD500 million or the assets under its management shall be no less than USD1 billion; (*B*) it shall have a sound governance and internal control system and shall not have been subject to any sanction by onshore judicial departments or relevant supervision organizations within the most recent two (2) years; (*C*) it shall be mainly comprised of offshore sovereign wealth funds, pension funds, endowment funds, charitable foundations, fund of funds, insurance companies, banks, security companies and other offshore institutional investors recognized by the Municipal Filing Office; (*D*) each offshore investor shall subscribe for at least USD10 million in the pilot equity investment enterprise; and (*E*) the offshore investor or its affiliates shall have more than five (5) years of relevant investment experience.

It is provided that no upper limit on foreign capital is set for pilot equity investment enterprises (i.e., the fund can be comprised solely of foreign capital), reflecting an open attitude of Tianjin toward introducing foreign capital. Meanwhile, the size of pilot equity investment enterprises in Tianjin is required to be no less than RMB500 million or equivalent amount of foreign currency, which is consistent with that in Beijing but much higher than the USD15 million required in Shanghai. In addition, as to the minimum capital commitment for offshore investors, the Tianjin QFLP Measures state the minimum requirement of USD10 million, which is higher than that for limited partners of pilot enterprises in Shanghai (i.e., USD1 million).

Investment by Pilot Enterprises

A pilot equity investment management enterprise is allowed to settle foreign capital with its custodian bank according to applicable foreign exchange regulations, and further makes capital commitment to the equity investment enterprise established by it. Such capital contribution by pilot equity investment management enterprise will not affect the nature of the equity investment enterprise invested by it. The amount of foreign capital settlement by a pilot equity investment management enterprise is limited to 5% of the paid-in capital (including accumulative amount of settled capital) of the equity investment enterprise, which is generally consistent with the QFLP measures in Beijing and Shanghai.

In addition, the Tianjin QFLP Measures and the Implementing Rules impose following investment prohibitions on pilot enterprises: no investment in industries where foreign investments are prohibited; no secondary securities transactions; no financial derivatives transactions; no non-self-use real estate investment; no use of proprietary funds to make investments; no provision of loans or guarantees to any third party; and no engagement in other activities prohibited by applicable law or the articles of association (or the partnership agreement) of the equity investment enterprises.

Fund Custody and Foreign Exchange Settlement for Pilot Enterprises

According to the Tianjin QFLP Measures and the Implementing Rules, pilot enterprises shall entrust the head office or the branch office of a commercial bank that satisfies relevant requirements and conditions as the custodian bank. In addition, pilot equity investment enterprises shall open several accounts with its custodian bank, including (i) a designated

foreign exchange account (foreign capital account for legal person enterprises and designated foreign capital account for non-legal person enterprises), to accept capital contributions by offshore investors; (ii) a designated investment account, to collectively manage the settled capital of the pilot equity investment enterprise and its investment; and (iii) a designated proceeds account, to collect investment proceeds and other earnings. Pilot equity investment enterprises with onshore investors shall open an RMB settlement account to accept capital contributions of the onshore investors.

In addition, the foreign capital settlement for a pilot enterprise shall be based on the actual need of its investment (i.e., within the upper limit on foreign capital settlement, pilot enterprises will only be allowed to settle its foreign capital for the amount actually needed for its impending investments). According to the Implementing Rules, the investment made by pilot equity investment enterprises using its settled capital shall be regarded as foreign direct investment, which requires prior approval from local DRC and Commission of Commerce where the target company is located. After the verification and check by Tianjin Administration of Foreign Exchange, pilot equity investment enterprises may, within its settlement limit, apply to its custodian bank for foreign capital settlement in accordance with its investment schedule. The settled capital shall be put in the designated investment account and shall be used within seven (7) business days after the RMB capital and foreign capital have been collected at the percentage agreed upon at the registration. Otherwise, the qualification of the pilot enterprise will be revoked.

We note from the aforesaid provisions that compared to the Beijing and Shanghai QFLP regulations, the Tianjin regulations impose more detailed and comprehensive requirements for foreign capital settlement, and exercise a stricter scrutiny over the investment activities of foreign-invested equity investment enterprises.

Important Announcement

This Newsletter has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

If you have any questions regarding this publication, please contact:

Contact Us

Beijing Office
Tel.: +86-10-8525 5500
Suite 906, Office Tower C1, Oriental Plaza
No. 1 East Chang An Ave.
Beijing 100738, P. R. China

Rong CHEN Attorney at-law
Tel.: +86-10-8525 5541
Email: estella.chen@hankunlaw.com

Shanghai Office
Tel.: +86-21-6080 0909
Suite 5709, Tower 1, Plaza 66, 1266 Nanjing West Road,
Shanghai 200040, P. R. China

Anita SUN Attorney-at-law
Tel.: +86-21-6080 0907
Email: anita.sun@hankunlaw.com

Shenzhen Office
Tel.: +86-755-3680 6500
Suite 4709, Excellence Times Plaza, 4068 Yitian Road, Futian District,
Shenzhen 518048, P. R. China

Jason WANG Attorney at-law
Tel.: +86-755-3680 6518
Email: jason.wang@hankunlaw.com

Copyright © 2004-2011 Han Kun Law Offices All Rights Reserved