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# Newsletter

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## Legal Updates

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## Legal Updates

### 1. Summary of New Interim Measures on Private Equity Investment Funds (Authors: Evan ZHANG, James WANG, Shang XIANG)

On August 21, 2014 China Securities Regulatory Commission (the “**the CSRC**”) officially released the *Interim Measures for Supervision and Administration of Private Equity Investment Funds* (the “**Private Equity Measures**”) which became effective at the same date. After a long time legal study and then soliciting opinions from the public for more than one month, the Private Equity Measure has finally come into sight, which officially announced the regulatory power of the CSRC on private equity investment funds. Compared with the *Interim Measures for Supervision and Administration of Private Equity Investment Funds (Draft for Comments)* published by the CSRC on July 11, 2014, there are no substantial changes to the general principles, but some specific amendments provisions are modified in the Private Equity Measures.

The Private Equity Measures is composed of 10 chapters and 41 sections in total, and the regulatory system mainly focuses on five aspects: (i) integrated registration and record-filing system; (ii) qualified investors threshold; (iii) fund-raising regulations; (iv) investment operational rules; and (v) special measures on venture capital funds. The main content of the Private Equity Measures is summarized as follows:

#### (1) The Scope of Application of the Private Equity Measures

Pursuant to the Private Equity Measures, the private equity investment funds (the “**PE Funds**”) refers to the investment funds established within the People’s Republic of China, by private offering and fund-raising targeting qualified investors.

The Private Equity Measures shall apply to the registration, record-filing, fund-raising activities, and investment operation of any company or partnership established by private offering and fund-raising to carry out investment activities, whose assets are managed by its fund manager or general partner. The Private Equity Measures shall also apply to the securities companies, public fund management companies and futures companies and their subsidiaries engaged in the private equity investment business.

#### (2) Integrated Registration and Record-filing System for PE Funds and their Managers

In respect of the registration and record-filing system of PE Funds and the managers of PE Funds (the “**Manager**”), the Private Equity Measures maintain the approach stated in *Measures for Registration of Private Equity Investment Funds Managers and Filing of Funds (Trial)* issued by Asset Management Association of China (the “**AMAC**”) this January, which adopted an “post-establishment supervision” method instead of administrative pre-approval on

setup of the Manager or completion of funds raising. Pursuant to the Private Equity Measures, Managers shall, apply with the AMAC for registration and submit relevant information in accordance with requirements announced by the AMAC, then after the completion of fund-raising, the Manager shall cause the fund under its management to go through the record-filing procedures and submit the relevant information in accordance with requirements announced by the AMAC.

Due to the nature of such post registration and record-filing, the Private Equity Measures further clarifies that the registration of a Manager and the record-filing of a PE Fund with the AMAC shall not constitute a recognition of the investment capacities and continuous compliance of the Manager, and shall not serve as any kind of guarantee for the security of fund assets.

### (3) The Qualified Investors

To be a qualified investor under the Private Equity Measures, three main requirements shall be satisfied: the minimum subscription amount, size of assets and income level, and the capacity to identify and take the investment risk. Pursuant to the Private Equity Measures, the minimum investment amount for a qualified investor in a single PE Fund shall not be less than RMB 1 million. In addition, for a qualified individual investor the financial assets shall not be less than RMB 3 million or average annual income shall not be less than RMB 500 thousands over the past three years; and for a qualified institution investor, its net assets shall not be less than RMB 10 million. Take some special situations into consideration, investors falling into either of the following four categories shall be deemed as qualified investors under the Private Equity Measures : (i) pension funds such as social security funds and enterprise, etc., and social welfare funds such as charitable funds; (ii) investment plans which is duly and legally established and filed record with the AMAC; (iii) Managers and their staffs investing in PE Funds under their own management; and (iv) other investors specified by the CSRC.

With respect to the number of investors, the Private Equity Measures requires the cumulative number of investors in a single PE Funds shall not exceed the specific number stipulated in *the Securities Investment Fund Law, the Company Law, the Partnership Enterprise Law* and any other applicable laws and regulations. The Private Equity Measures also adopts a "Pierce-through" Principle, which means if the PE Funds are directly or indirectly invested by a partnership or any other organizations without a legal person status (i.e., corporation based on contract.) with the capital raised from numerous investors, the Managers and sales agencies of PE Funds shall inspect and examine the investors at each layer of the structure to make sure that the ultimate beneficiaries are qualified investors and investors at each layer shall be counted in to calculate the final number of the investors. However, the Pierce-through principle shall not apply to such investors falling into category (i), (ii) or (iv) as stated above deemed as qualified investors.

### (4) Fund Raising Rules for PE Funds

Regarding targets and methods of fund raising, the Private Equity Measures states that the Manager and sales agencies of PE Funds shall not raise funds from entities or individuals other than qualified investors, conduct promotion and marketing activities towards unspecified objectives through newspapers, periodicals, radios, television, broadcasting, Internet and any other public media, or lectures, briefings and analysis meetings, or in the form of posting notices, distributing flyers, sending short messages, using We Chat, blogs, e-mails, etc.

In respect of cash income, the Manager and sales agencies of PE Funds managers and shall not make any guarantee of no loss to the capital principal or ensure the minimum profits to the investors.

With respect to the investors' abilities to identify risks, the Private Equity Measures requires, (i) if the Manager sells units of PE Funds on their own, the Manager shall make evaluation on risk identification and tolerance abilities of the investors by questionnaires or any other methods and the investors herein shall make written confirmation that he or she is a qualified investor, and the Manager shall also prepare the Risk Disclosure Statement to be signed by the investors as confirmation; (ii) where a sales agency is entrusted by the Manager to sale units of PE Funds, the assessment and conformation and other measures stated in (i) shall be implemented by the agency. Whether the units of PE Funds are sold by the Manager or a sales agency, the risk rating shall be conducted by them or by a third party engaged by the Manager or the sales agency, and the promotion and marketing target shall be those investors with proper risk identification and tolerance abilities.

For the source of the Capital, the investors shall ensure the capital invested in PE Funds are from legitimate source, and shall not collect funds of others in an illegal manner to invest in the PE Fund.

#### (5) Investment Operation Rules of PE Funds

The Private Equity Measures standardizes rules in respect of investment activities and operation of PE Funds, including: (i) the fund contract shall be formed and entered into in accordance with or with reference to *the Securities Investment Fund Law*; (ii) the custodian of capital of PE Funds shall be arranged in accordance with the fund contract. But where the capital of the PE Fund is exempted from custodian pursuant to the fund contract, systems and measures to safeguard the security of property of the PE Fund private fund and a dispute resolution mechanism shall be explicitly stipulated in the fund contract; (iii) where potential interest tunneling or interest conflict exists between various PE Funds due to management of the same Manager, precaution systems shall be established; (iv) prohibited investment activities of managers, custodians, sales agencies or other service institution practitioners of PE Funds are listed; (v) the Manager shall accurately disclose the facts to investors the significant information that may affect their legitimate rights and interests. Furthermore, The Private Equity Measures also has stipulations on submitting of information and keeping and saving of

important documents.

#### (6) Special Stipulations on Venture Capital Funds

The Private Equity Measures leave a special chapter on venture capital funds, making emphasis on differentiated supervising system and self-discipline arrangement, by the CSRC, the AMAC, and its dispatched authorities. The Private Equity Measures states that the venture capital funds shall refer to the private equity investment fund primarily investing in ordinary shares of unlisted venture companies, or preferred shares which may be legally convertible into ordinary shares, convertible bonds and other rights and interests. It is understood that PE Funds shall clearly indicate, in accordance with regulations and rules of AMAC, its investment orientation and type categorized based such investment orientation. In connection with the *Measures for Registration of Private Equity Investment Funds Managers and Filing of Funds (Trial)*, and those registration and filing procedures publicly accessible online, funds can be categorized into private securities investment funds which mainly invest in securities listed on public exchanges, private equity investment funds which mainly invest in private equities not publicly traded, and other private investment funds which investing in art works, red wines and other specific merchandise, among which venture capital funds are listed separately as a special kind of private investment funds.

#### **Conclusions:**

The Private Equity Measures is a regulation initially and officially published concerning supervision and administration of PE Funds. We have the view that the issuance of the Private Equity Measures will promote the development PE Funds industry of the PRC in a healthy and steady way. Meanwhile, much higher practicing standards are raised for the industry and its practitioners along with the CSRC's bringing the PE Fund industry into the orbit of its supervision and administration.

## **2. MOFCOM Revised Administrative Measures for Outbound Investment to Facilitate the Procedure of Outbound Investment (Authors:Gloria XU, Diana CHEN, Wenjin ZHANG)**

MOFCOM promulgated the newly-revised *Administrative Measures for Outbound Investment* (Order of the Ministry of Commerce [2014] No.3, "**the Measures**") on September 6<sup>th</sup>, 2014, which shall come into force as of October 6<sup>th</sup>, 2014. *Administrative Measures for Outbound Investment* (Order of the Ministry of Commerce [2009] No.5, **the "Former Measures"**) issued in 2009 shall be repealed simultaneously. This revision simplifies the process of administrative examination and approval and institutes the decentralization, thereby defining the dominant position of the enterprises in outbound investment and further facilitating the process thereof.

The *Measures* include 39 articles in five chapters, covering *General Provisions, Archive Filing and*

*Verification, Rules and Services, Legal Liabilities, and Supplementary Provisions.* Comparing with *the Former Measures*, the principal innovations of *the Measures* are listed as follows:

(1) Defining the Dominant Position of the Enterprises in Outbound Investment

*The Measures* clearly stipulate in *General Provisions* that an enterprise which makes outbound investment shall “make decisions independently and be responsible for its own profits and losses in accordance with the law”, and delete the requirement for an enterprise to obtain the approval from the competent government authority before the contracts and agreements regarding its outbound investment take effect. Those revisions are beneficial to the implementation of the enterprises’ autonomy in investment decision and the promotion of the outbound investment facilitation.

(2) Establishing the Administration System of “Primarily by Archive Filing, Supplementarily by Verification”

According to *the Measures*, owning the non-financial enterprises or obtaining the ownership, control right or management right or other interests of the existing non-financial enterprises through establishing the a new enterprise, merger and acquisition, or other means. Where the outbound investment carried out by an enterprise involves sensitive countries, regions and sensitive industries, approval shall be needed issued by Ministry of Commerce or the local branch thereof. While in other circumstances of outbound investment, archive filing management shall be implemented. For outbound investments subject to archive filing, a central enterprise shall report its outbound investments to the Ministry of Commerce for filing and a local enterprise to the provincial department in charge of commerce at its locality.

“Sensitive Countries” in *the Measures* refer to countries that have not established diplomatic relations with China and countries under the United Nations’ sanctions. The query methods of the above-mentioned categories of countries are provided in the *Outbound Investment Archival Filing Form* and the *Outbound Investment Application Form* attached to *the Measures*. According to the *Measures*, when necessary, MOFCOM could separately announce the list of countries and regions for which verification management required. “Sensitive Industries” in *the Measures* refer to industries involving exportation of products and technologies which is restricted by China, or industries affecting the interests of a country (region) or more.

(3) Narrowing the Coverage and Limitation Period of the Verification

*The Measures* cancel the requirements for approving the outbound investment above designated investment amount and establishing special purpose vehicles. The *Measures* also cancel the requirement for obtaining opinions from relevant Chinese chambers of commerce and associations on approving outbound investments on exploration and development of mineral resource. In conclusion, if not involving sensitive countries and regions and sensitive industries, the outbound investment no longer needs to be approved.

The *Measures* shorten the approving period. The outbound Investment of a central enterprise shall be decided within 20 working days (including the time for seeking opinions from (the economic and commercial counselor's office of) the embassy (consulate) of China in the country concerned) after accepting the application. The outbound Investment of a local enterprise shall be decided within 30 working days, of which the provincial commerce department shall submit preliminary review opinions and all application materials to MOFCOM within 15 working days (including the time for seeking opinions from (the economic and commercial counselor's office of) the embassy (consulate) of China in the country concerned); MOFCOM shall decide whether to approve the application within 15 working after receiving the preliminary review opinions.

(4) Clarifying the Requirements and Procedures for Archive Filing

*According to the Measures*, central enterprises and local enterprises shall fill out and print out *the Outbound Investment Archival Filing Form* (hereinafter referred to as *the "Archival Filing Form"*) through "*Outbound Investment Management System*", then report the form bearing its seal along with the copies of business license to MOFCOM and the provincial commerce department, respectively, for archive filing. Where *the Archival Filing Form* is filled out accurately and completely and in the legal form, and an enterprise states in *the Archival Filing Form* that its outbound investment does not fall under any circumstance specified in Article 4 of the *Measures*, MOFCOM or the provincial commerce department shall record the same and issue *the Certificate of Outbound Investment by Enterprises* within three working days upon receiving the application.

(5) Cancelling the Mandatory Requirement of the Limitation Period of the Outbound Reinvestment's Archive Filing

*According to the Former Measures*, the outbound reinvestment of an overseas enterprise invested by an enterprise shall be reported to the competent department in charge of commerce by the enterprise within one month after the overseas legal procedure is completed. *The Measures* cancel the mandatory requirement of the limitation period, whereupon the outbound reinvestment of an overseas enterprise invested by an enterprise might be reported to the competent department in charge of commerce by the enterprise at any time after the overseas legal procedure is completed.

(6) Facilitate the Enterprises to Handle Business Locally

*According to the Measures*, the provincial commerce departments should take charge of the archive filing administration of their local enterprises' outbound investment and starting business overseas, and *the Certificate of Outbound Investment by Enterprises* could be sealed printed and issued by themselves. This altered the former practice that *the Certificate of Outbound Investment by Enterprises* must be uniformly printed by MOFCOM (but the uniform

coding system remains the same). By administrating locally, *the Measures* manage to promote the facilitation of outbound investment.

(7) Strengthening Guidance and Regulation for Outbound Investment

*In Chapter 3 Rules and Services, the Measures* require the overseas enterprises to strengthen the consciousness of risk and responsibility, observe the laws and regulations of the investment destination, respect local customs, perform social responsibility, and take responsibility in respect of environment protection, labor protection, and enterprise cultural construction so as to better integrate with the local society.

(8) Strengthening Legal Liability and Increasing Penalties

*In Chapter 4 Legal Liabilities, the Measures* revise the penalties of going through filing procedures and obtaining the Certificate by providing false materials or by any improper means, and falling under any circumstance specified in Article 4 thereof in the process of outbound investment. And the intensity of the penalties is greatly enhanced. *The Measures* also claim that if a crime is constituted, the enterprise shall be prosecuted for criminal liabilities in accordance with the law.

(9) Transforming Government Functions, Improving Services and Guarantees

*The Measures* instruct MOFCOM and the provincial commerce departments to improve work efficiency and to provide quality services. MOFCOM shall promulgate *the Guidance on Foreign Countries (Regions) for Outbound Investments and Cooperation*, industry guidelines of countries and other documents to help enterprises to understand the investment environment of investment destinations; it shall strengthen the guidance and regulation over outbound investments of enterprises, and, in concert with the relevant departments, promulgate environmental protection guidelines to urge enterprises to operate overseas in accordance with laws and regulations; it shall also set up an outbound investment and cooperation information service system to provide information services including statistics, investment opportunities, investment barriers and risk pre-warning for enterprises to carry out outbound investments.

## **Important Announcement**

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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

#### **Estella CHEN Attorney-at-law**

Tel.: +86-10-8525 5541  
Email: [estella.chen@hankunlaw.com](mailto: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

#### **Yinshi CAO Attorney-at-law**

Tel.: +86-21-6080 0980  
Email: [yinshi.cao@hankunlaw.com](mailto:yinshi.cao@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](mailto:jason.wang@hankunlaw.com)