HAN KUN LAW OFFICES

Legal Commentary

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PRIVATE EQUITY

Interpretation of The "Notice on Relevant Issues Relating to the Waiver of the Obligation to Transfer State-Owned Shares Held by State-Owned Venture Capital Enterprises and State-Owned Venture Capital Guiding Funds"

- **BACKGROUND**

In order to enrich China's national social security fund and cope with the pension shortfall issue caused by the aging of the Chinese population, on June 19, 2009, the State Council promulgated the "*Measures on Enriching the Social Security Fund by Transferring Some State-Owned Shares in the Onshore Securities Market*" (the "**Measures**") requiring the transfer of certain state-owned shares of listed companies to the National Social Security Fund Council (the "**NSSFC**"). In the case of initial public offerings occurring after the promulgation of the Measures which include state-owned shares, 10% of the total shares to be listed (but not to exceed the shares actually owned by the state-owned shareholders) is required to be transferred to the NSSFC, subject to the same lock-up period as they are in the hands of the transferring state-owned shareholders. For initial public offerings occurring after the 2006 reform of the non-tradable shares (state-owned shares) and prior to the promulgation of the Measures, ten percent (10%) of the shares actually publicly issued at that time should be transferred to the NSSFC retroactively, which shares shall be subject to three (3) more years of lock-up in addition to the transferring shareholders' lock-up period.

Driven by the high valuation of the Shenzhen Growth Enterprise Market (the "**SGEM**"), listings on the SGEM have become an important avenue for venture capital enterprises ("**VCEs**") to reap high returns from their venture investments. However, the mandatory share transfer obligation under the Measures would cause the IRRs of state-owned venture capital enterprises' ("**State Owned VCEs**'") to be reduced significantly, in some cases down to zero. The Measures thus have a significant effect of suppressing the investment enthusiasm of State-Owned VCEs and have led some State-Owned VCEs to absorb private capital in order to take off the "State Owned" hat. In order to boost State-Owned VCEs' enthusiasm to invest and promote the healthy development of SGEM listings, the Ministry of Finance (the "**MOF**"), State-owned Assets Supervision Administration Commission (the "**SASAC**"), China Securities Regulatory Commission (the "**CSRC**") and other agencies jointly promulgated the "*Notice on Relevant Issues Relating to the Waiver of the Obligation to Transfer State-Owned Shares Held by State-Owned Venture Capital Enterprises and State-Owned Venture Capital Guiding Funds*" (the "**Notice**") in order to address the abovementioned problems as a result of the promulgation of the Measures.

● KEY POINTS OF THE NOTICE

According to the Notice, qualified State-Owned VCEs and State-Owned Venture Capital Guiding Funds ("**State-Owned Guiding Funds**") investing in privately held small or medium-sized enterprises ("**SMEs**") may apply for the waiver of the mandatory obligation to transfer shares to the NSSFC. Relevant key concepts, eligibility requirements and application procedures are described as follows:

1. Key Concepts

1) State-Owned Shareholders: shareholders determined by the State-owned Assets Supervision Administration as "State-Owned Shareholders";

2) State-Owned Share: shares received by the State-Owned Shareholders through investments in unlisted SMEs;

3) Unlisted SMEs: Privately held SMEs with (1) no more than 500 employees; (2) no more than RMB200,000,000 in annual sales; and (3) no more than RMB200,000,000 in total assets.

2. Eligibility Requirements

1) State-Owned VCEs

(1) Business scope limitation: the business scope of State-Owned VCEs should be limited to: (1) making venture capital investments (for its own account); (2) making venture capital investments on behalf of other venture capital enterprises, organizations or individuals; (3) conducting venture capital consulting business; (4) providing venture capital management service to venture enterprises; (5) participating in the establishment of venture capital enterprises and venture capital management consulting institutions.

(2) Name Limitation: the registered name should include the words "venture capital". In the case the industrial and commercial registration has been completed prior to the promulgation of the "*Interim Administrative Measures on Venture Capital Enterprises*" (the "**Interim Measures**") by the National Development and Reform Commission (the "**NDRC**") and other government agencies in November 2005, the original registered name may be kept, but the business scope must meet the requirements in (1) above.

(3) The past venture capital filing is lawful: the state-owned shareholders should file information regarding the transfer of the state-owned shares (or alternative ways to fulfill the transfer obligation) and general contributions books (copies) and other documents with the State-owned Assets Supervision Administration within thirty (30) days after the completion of the share transfer (or alternative ways to fulfill the transfer obligation).

Please note that Equity Investment Funds that do not primarily invest in emerging companies may also make filings with the NDRC according to the Interim Measures and thus become eligible for receiving investment from the NSSFC. However, strictly speaking, Equity Investment Funds cannot meet the aforesaid (1) and (2) requirements and thus are not eligible for the waiver.

2) State-Owned Guiding Funds

In order to be eligible, State-Owned Guiding Funds have to be established and operate pursuant to the "*Guiding Opinions on the Establishment and Operation of Venture Capital Guiding Funds*" (Guobanfa [2008] 116) (the "**Guiding Opinions**").

3. Main Documents Needed to be Submitted

1) Application Report;

2) Supporting documents to prove the completion of filing with the NDRC and annual inspection of the State-Owned VCE according to the Interim Measures and a detailed explanation that the State-Owned Guiding Fund has been established and operates according to the Guiding Opinions.

3) Audited financial statements of the investee company for the year preceding the initial investment by the State-Owned VCE or State-Owned Guiding Fund.

4) Evidence of the number of employees of the investee company at the end of the year preceding the investment by the State-Owned VCE or the State-Owned Guiding Fund issued by the Labor and Social Security Administration in the same locality of the investee company.

4. Application Procedures

1) Waiver Application for the transfer obligation

(1) Time Limitation: prior to the initial public offering and listing;

(2) Applicant: qualified State-Owned VCEs or State-Owned VC Guiding Funds;

(3) Approval Authority: Ministry of Finance;

(4) Approval and Procedures: after the examination, the Ministry of Finance issues approval documents to waive the transfer obligation, with copy to SASAC, CSRC, NSSFC and relevant provincial (autonomous region and municipality) State-owned Assets Supervision Administration and Treasury Department. If there are other state-owned shareholders in the investee enterprise, the waived state-owned shares should be deducted from the total amount of shares that are otherwise subject to mandatory transfer.

2) The Return Application

(1) Time Limitation: after the shares have been transferred to the NFFSC according to the Measures;

(2) Applicants: qualified State-Owned VCEs and State-Owned Guiding Funds;

(3) Approval Authority: Ministry of Finance;

(4) Notice and Procedures: after the examination by the Ministry of Finance and the NSSFC, they will issue a return notice to the China Securities Depository and Clearing Co. , Ltd. (the "**CSDCC**") with copy to SASAC, CSRC, NSSFC and relevant provincial (autonomous region and municipality) State-owned Assets Supervision Administration and Treasury Department. The CSDCC will reflect the return of such shares in the stock accounts of the NSSFC and the State-Owned VCE or State-Owned Guiding Fund.

● **ISSUES REQUIRING CLARIFICATION**

No definition of "State-Owned Shareholder" or "State-Owned Share" for purposes of the Measures and the Notice has been published by the State-owned Asset Supervision

Administration. It is not yet clear whether “State-Owned Shareholder” for purposes of the Measures and the Notice has the same meaning as “State-Owned Shareholder” under the “*Interim Administrative Measures on the Transfer of the Listed Companies’ Shares by the State-Owned Shareholders*”, i.e., enterprises, relevant authorities, departments, public institutions, etc. that are owned or controlled by the state.

There also is no definition of “State-Owned VCEs” in the Notice. According to relevant provisions of the Notice, in the case of non-wholly-state-funded VCEs, the state-owned investors of such state-owned VCEs should fulfill the mandatory share transfer obligation in accordance with its ownership percentage of the State-Owned VCE. This implies that State-Owned VCEs not only include wholly-state-funded VCEs but also non-wholly-state-funded VCEs controlled by the state.

The number of State-Owned VCEs meeting the requirements of the Notice on a national level is not very large, and the waiver of the mandatory transfer obligation only applies to shares in privately held SMEs. Thus, the scope of the waiver under the Notice is very limited, which serves to ensure the income stability of the NSFFC, but has a limited effect of promoting the investment enthusiasm of State-Owned VCEs and Guiding Funds.

We will continue to monitor the clarification of the aforementioned issues and the actual implementation of the waiver policy and will keep you up to date on any relevant information.

Important Announcement

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