



October 29, 2012

Private Equity Law

Shanghai RQFLP Pilot Program in Sight

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According to relevant sources, following the Qualified Foreign Limited Partner (“QFLP”) Pilot Program launched in December of 2010, Shanghai has recently been approved as the first city for the RMB Qualified Foreign Limited Partner Pilot Program (the “**RQFLP Pilot Program**”). The RQFLP Pilot Program will be initially implemented in Pudong New District. The detailed rules of the RQFLP Pilot Program will be jointly created by the State Administration of Foreign Exchange Shanghai Branch, the Shanghai Municipal Development & Reform Commission, the Shanghai Financial Services Office and other relevant authorities.

Introduction of RQFLP Pilot Program

Yet another new measure adopted in Shanghai to promote the backflow of offshore RMB funds, the RQFLP Pilot Program is based on the QFLP pilot program with respect to the RMB Qualified Foreign Institutional Investor (“**RQFII**”) program. In short, under the RQFLP Pilot Program, institutional investors satisfying relevant eligibility requirements may directly remit RMB funds raised overseas to Shanghai to set up private equity funds for private equity investments.

Although the RQFLP Pilot Program inherits certain characteristics of the QFLP pilot program and the RQFII program, there exist noticeable differences among them. Compared to the QFLP program, the RQFLP Pilot Program will broaden the channels for capital contribution, under which qualified foreign limited partners may use offshore RMB (as opposed to foreign currency) funds to set up private equity funds in China. As a result, the capital contribution and investment procedures are expected to be simplified to some extent. Compared to the RQFII program that is geared toward securities market investments, qualified foreign limited partners under the RQFLP Pilot Program may deploy offshore RMB capital for making equity investments in non-listed enterprises and private placements in listed enterprises.

Key Issues concerning RQFLP Pilot Program

1. Who can apply

While details of the RQFLP Pilot Program are not known yet, it is very possible that the applicants will initially be limited to the Hong Kong subsidiaries of Chinese asset management companies and brokerage firms, which is similar to the RQFII program. Haitong International, the Hong Kong subsidiary of the Shanghai-based brokerage firm Haitong Securities, has been reported to have entered into a memorandum of understanding with Bank of Shanghai and will apply for a RQFLP quota of the USD 100 million equivalent of RMB.

2. National Treatment

In response to Blackstone's request to clarify the domestic nature of its Shanghai-based RMB fund¹, in April 2012 the National Development and Reform Commission issued the *Reply Letter of the General Office of NDRC on Relevant Issues Relating to Foreign-invested Equity Investment Enterprises (FaGai Ban WaiZi [2012] 1023)* (the "**Reply Letter**"). The Reply Letter clarified that Blackstone's RMB fund and similar limited partnership funds with a general partner that is a foreign-invested enterprise and limited partners that are domestic investors shall be subject to foreign investment laws and policies and the *Catalogue for Guiding Foreign Investments*. As a result, this Reply Letter has dealt a major blow to the foreign private equity community in China, significantly reducing the interest of foreign private equity firms in the QFLP program.

While the detailed rules are yet to come, according to relevant officials in the financial bureaucracy in Shanghai, RMB funds set up through the RQFLP Pilot Program will still be considered foreign capital subject to the relevant rules and restrictions on foreign investments.

3. Extent of Regulation

To prevent the excessive inflow of offshore hot money, the regulatory authorities in the beginning generally adopt a cautious approach towards the pilot programs of new policies involving foreign exchange, offshore RMB and their implementation, only to relax restrictions as the pilot programs progresses. For example, the RQFII policy implemented at the beginning of this year was subject to significant restrictions on its size, scope of allowed investments and portfolio allocation at the initial stage imposed by regulators. The initial size of the total approved RQFII quota was only RMB 6 billion, but it was quickly increased by RMB 50 billion in just a few months after the implementation of the program.

As a new measure for the backflow of offshore RMB funds, the RQFLP Pilot Program will further broaden the channels for the backflow of offshore RMB and permit offshore RMB to be

¹The Blackstone's Shanghai-based RMB fund raised most of its capital from domestic RMB investors, with its foreign element limited to its GP contribution in the amount of no more than 5% of the size of the fund, which under the Shanghai QFLP regulation would not affect the nature of its portfolio companies.

deployed for investing in the domestic real economy. However, given the current relative chaotic situation in the national and local regulation of domestic private equity funds and to prevent the overheating of certain parts of the real economy, the regulators likely will initially take small steps with respect to the RQFLP Pilot Program.

We will continue to closely watch the implementation of the RQFLP Pilot Program and will update you on its latest developments.

Important Announcement

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