



漢坤律師事務所  
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## Legal Updates

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# Legal Updates

## 1. Interpreting Draft Foreign Investment Law from VIE Perspectives

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On December 23, 2018, the *Foreign Investment Law of the People's Republic of China (Draft)* (the “**2018 Draft**”) was submitted for deliberation to the Seventh Session of the Thirteenth Standing Committee of the National People's Congress. The 2018 Draft<sup>1</sup> had been published on the official website of the National People's Congress on December 26, 2018 for public comment until February 24, 2019.

A foreign investment legal system framework based on the existing “three foreign capital laws” (the Law on Sino-Foreign Equity Joint Ventures, the Law on Sino-Foreign Contractual Joint Ventures and the Law on Foreign-Capital Enterprises) has gradually formed in China over the past 40 years since the country's reform and opening up. The newly enacted Foreign Investment Law will replace the three foreign capital laws to become the legal foundation for foreign investment in China in the new era.

The 2018 Draft is not the first attempt to establish a unified legal system for foreign investment. As early as January 2015, the Ministry of Commerce promulgated the *Foreign Investment Law of the People's Republic of China (Draft for Comment)* (the “**2015 Draft**”) <sup>2</sup>. Compared with the 2015 Draft, the 2018 Draft saw major changes in content and structure, by reducing 170 articles to 39 and mainly stipulating details for the promotion, protection and management of investment. What is most noteworthy, however, is not what the 2018 Draft stipulates, but what has been deleted or modified as compared with the 2015 Draft. This article will analyze the 2018 Draft mainly from the perspective of variable interest entities (“**VIEs**”).

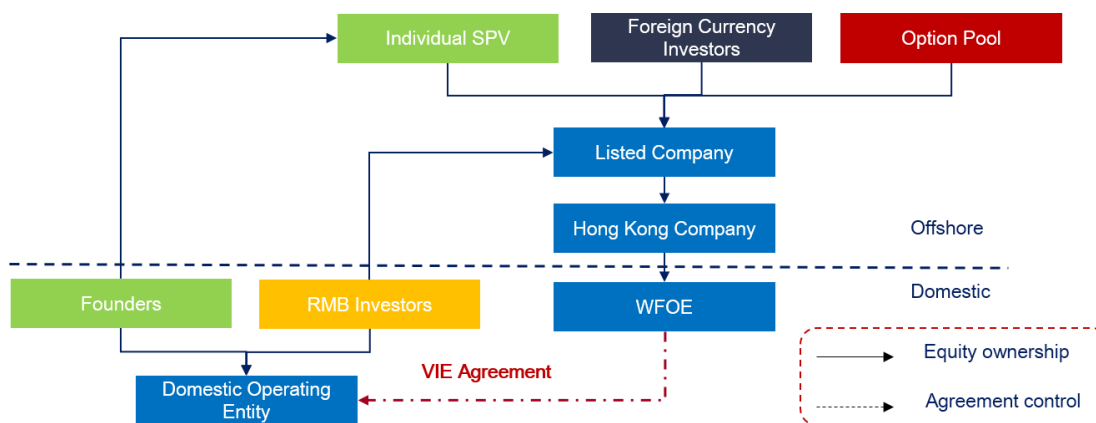
### VIE Structures

VIE structures, also known as “agreement control” or “contractual arrangements”, refers to achieving actual control and consolidation in financial statements of PRC operating entities through various contractual agreements rather than through equity ownership. A VIE structure is typically arranged as follows:

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<sup>1</sup> [http://www.npc.gov.cn/COBRS\\_LFYJNEW/user/Law.jsp](http://www.npc.gov.cn/COBRS_LFYJNEW/user/Law.jsp)

<sup>2</sup> <http://tfs.mofcom.gov.cn/article/as/201501/20150100871010.shtml>



Since 2000, when Sina completed its U.S. initial public offering through adopting a VIE structure, VIE structures have been widely used by PRC enterprises that involve foreign investment restricted or prohibited industries (such as technology, media and telecommunications, private education, etc.) to create overseas red-chip structure for the purpose of financing or listing overseas.

However, currently effective PRC laws and regulations have not clearly characterized VIE structures. As a consequence, PRC companies which adopt a VIE structure have needed to provide in their prospectuses a special section on “contract arrangements” and to disclose relevant legal opinions of PRC legal counsel to complete overseas initial public offerings. Thus, relevant PRC enterprises have had to pay attention to legislative and enforcement developments with respect to the legality of VIE structures and oversight models.

### **Review: The 2015 Draft proposed to subject VIE structures to the supervision of the foreign investment regulatory system.**

The 2015 Draft first attempted to combine the three foreign capital laws into a unified legal system for foreign investment, and clearly defined VIE structures as a form of foreign investment.

- With regard to the definition of “foreign investment”, Article 15 stipulated that foreign investment referred to, among others, “control” of a domestic enterprise or the holding of an interest in a domestic enterprise by foreign investors through contracts, trusts, etc., which shall be governed by investment access management provisions, security reviews, information reporting on foreign investment under the foreign investment law.
- With regard to the definition of “foreign investor”, Article 11 stipulated that foreign investors also included domestic enterprises that are “controlled” by non-PRC nationals, overseas registered entities and other organizations.
- With regard to the definition of “control”, Article 18 further clearly stipulated three means of control, specifically: (1) by acquiring more than 50% of the equity, voting rights or similar rights of the controlled enterprise; (2) in the absence of 50% equity ownership, (i) be entitled to decide the appointment of more than half of the board members of the controlled enterprise; (ii) have a significant impact on the shareholders' meeting or the board of directors of the controlled enterprise; or (3) be able to exert

decisive influence on the business, finance, personnel or technology of the controlled enterprise through contracts, trusts, etc.

Based on the above definitions of “control”, Article 45 further clarified that foreign investors controlled by domestic investors (including domestic natural persons or enterprises), may apply for their investments to be deemed as a domestic, rather than foreign, so as to avoid the requirements for “foreign investment”.

The *Explanations on the Foreign Investment Law of the People's Republic of China (Draft for Public Comments)*, issued by the Ministry of Commerce, failed to clearly stipulate the treatment of VIE structures, but proposed three potential solutions, i.e. a declaration system, declaration and certification system and a licensing system.

The 2015 Draft attracted widespread attention immediately upon promulgation. The Hong Kong Stock Exchange even updated its HKEX-LD43-3 listing decision document and GL77-14 guidance to recommend VIE-structured IPO applicants to consult the exchange in advance for informal and confidential guidance on novel issues, and expressly required applicants to disclose in their prospectuses the content required under the 2015 Draft and the measures (if any) that applicants would implement to reduce any potential risks upon consulting with PRC legal counsel.

### **At present: The 2018 Draft temporarily sets aside VIE structure-related issues**

It is notable that the 2018 Draft makes no mention of VIE structures.

Compared with the definition of “foreign investment” in the 2015 Draft, the 2018 Draft in paragraph 2, Article 2 deletes from the definition of “foreign investment” the “providing financing of terms of one year or more to domestic enterprises in which [the foreign investor] holds an interest”, “acquiring concessions for the exploration and development of natural resources, or obtaining concessions for the construction and operation of infrastructure within territory of China or other regions under the jurisdiction of China”, “acquiring real estate rights such as domestic land-use rights and real estate ownership within the territory of China” and “controlling domestic enterprises or holding rights and interests in domestic enterprises through contracts, trusts, etc.” Instead, the 2018 Draft adds a catch-all provision, “investments made by foreign investors in China through means stipulated by laws or administrative regulations or other methods prescribed by the State Council.” In addition, the concept of “actual controller” and related provisions as first proposed in the 2015 Draft are deleted in their entirety. As a result, the 2018 Draft, if adopted in its current form, may again return to a gray area those issues relating to VIE structure legality and oversight models.

What was the legislative intent behind removing VIE structure-related content from the 2018 Draft? The *Explanations on the Foreign Investment Law of the People's Republic of China (Draft for Comment)*<sup>3</sup> state that the views behind the law are “based on the principle of promoting the all-round opening, highlighting the tone of expanding opening and actively utilizing foreign capital, focusing on investment promotion and investment protection, firmly sticking to the Chinese government’s unwavering commitment to promote a new round of high-level opening.” The speech presented subsequently by the spokesperson of Ministry

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<sup>3</sup> [http://www.npc.gov.cn/COBRS\\_LFYJNEW/user/UserIndex.jsp?ID=13126141](http://www.npc.gov.cn/COBRS_LFYJNEW/user/UserIndex.jsp?ID=13126141)

of Commerce, Feng Gao, at a regular press conference<sup>4</sup> of the Ministry of Commerce on December 27, 2018 also provided some clues. “We believe that the introduction of the Foreign Investment Law will soothe the minds of foreign investors and foreign-invested enterprises.” He said, “we will adapt to the new situations and grasp new features, promote all-round opening up, further relax the access of foreign-investment and promote relevant departments to accelerate the opening in the fields of telecommunications, education, medical care, and culture in accordance with the deployment of the Central Economic Work Conference. Foreign shareholding restrictions will be further relaxed especially in the fields of education and medical care, to which foreign investors pay close attention and in which there is a large gap in the domestic market.”

Based on above, we have reason to speculate that under the background of the 40th anniversary of reform and opening-up and Sino-U.S. economic friction and consultations, the Foreign Investment Law focuses more on solving a series of urgent issues, such as expanding opening up, clarifying to apply the pre-entry national treatment plus negative list management system to foreign investment and building a fair competition environment for domestic and foreign capital. In this sense, the current legislation temporarily sets aside issues that still remain controversial but are relatively less urgent, such as the legality of the VIE structure and the identification of foreign investors by the source of capital rather than the place of registration (i.e. the 2015 Draft), and leaves those less urgent issues to legislative authorization. This means that VIE structures may in the future still be regarded as “foreign investment” under separate laws, administrative regulations formulated by the State Council, and regulatory documents according to the catch-all provision found in paragraph 2, Article 2 of the 2018 Draft.

## Outlook: Exploring regulatory views

As mentioned above, the 2018 Draft temporarily sets aside issues relating to VIE structure legality and oversight models, but allows for future rulemakings to address these issues through the inclusion of a catch-all provision. So, what will VIE-structured enterprises face in the future regarding the regulatory environment? We speculate that VIE structure regulation may be temporarily suspended in all aspects or will be implemented as a pilot program in certain sensitive industries (such as the private education industry).

We noted that, after the publication of the 2015 Draft, some separate laws and regulations promulgated in the private education industry began to adopt the concept of “agreement control” and reflected the tendency to incorporate “agreement control” into the scope of oversight, which has drawn the attention of capital markets. For example:

- According to the *Regulations for the Implementation of the Law of the PRC on Promotion of Privately-run Schools (Revised Draft) (Draft for Review)* promulgated by the Ministry of Justice in October 2018 (the “**Draft Regulations**”), “enterprises with foreign investment established in China and social organizations with foreign parties as actual controllers are not allowed to sponsor, participate in the sponsoring of or actually control privately-run schools providing compulsory education; the sponsoring of other types of privately-run schools shall comply with the national provisions on foreign

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<sup>4</sup> <http://www.mofcom.gov.cn/xwfbh/20181227.shtml>

investment ... a social organization implementing group-oriented running of schools is not allowed to control any non-profit privately-run school by means of merger and acquisition, franchise and chain operation, or by means of agreement-based control.”

- According to *Several Opinions on Deepening the Reform and Regulating the Development of Preschool Education*, promulgated by the Central Committee of the Communist Party of China and the State Council in November 2018, “social capital shall not control kindergartens and non-profit kindergartens invested with state-owned assets or collective assets through means of mergers and acquisitions, entrusted operations, franchise chains, variable interest entities, agreement control, etc.”

Since the above documents were published very near to the 2018 Draft, we believe that the Draft Regulation will provide a very valuable reference for predicting future regulatory views on the treatment of VIE structures:

- If issues related to VIE structures are also temporarily set aside by the State Council in the deliberation of the Draft Regulations (i.e. removing content related to “**agreement control**”), the VIE structure will face low risk of being subject to strict supervision in the short term.
- However, if the State Council ultimately retains relevant content related to VIE structures in the deliberation of the Draft Regulation, the private education industry will likely become a pilot industry for implementing foreign investment supervision of VIE structures, and the pilot may be further expanded to other specific industries and even be incorporated into the Foreign Investment Law if the effects of implementation are basically in line with legislative expectations.

In this respect, we will continue to monitor developments in this area.

## 2. Draft of Patent Law Amendments for Public Opinion

**Author: Dispute and IP Department**

After a long wait, the National People's Congress of China ("**NPC**") published the latest draft amendment of the Patent Law for public comment on January 4, 2019. According to the NPC's notice (see link), the general public are allowed to provide comments on the draft amendment via the NPC's website (see link) or by post before February 3, 2019.

The highlights in the latest draft amendment include:

- **Increased damages compensation (Amended Art. 72)** – The damages compensation for patent infringement is significantly increased in the amendment: (i) the court is allowed to award quintuple damages in cases of willful infringement; and (ii) the ceiling for statutory damages is increased from RMB 1,000,000 (USD 145,679) to RMB 5,000,000 (USD 728,215 ).
- **Shifted burden of proof regarding damages calculation (Amended Art. 72)** – If the right owner has exhausted its capacities to provide evidence regarding damages, the court can order the defendant to provide the relevant financial documents to ascertain the amount of the damages. If the defendant fails to comply, the court is allowed to award the damages compensations based on the claim and preliminary evidence set forth by the right owner.
- **Improved patent administrative enforcement proceedings (Amended Art. 70)** – The National Intellectual Property Administration of the PRC ("**CNIPA**") is allowed to accept and examine administrative complaints for patent infringement with nation-wide significance. The local IP Administrations are also allowed to accept and examine administrative complaints for patent infringement occurred within its geographic jurisdiction.
- **Additional liabilities for ISPs (Amended Art. 71)** – The right owner can request the Internet Service Provider ("**ISP**") to delete, block or disconnect the webpage links to the infringing products based on effective judicial or administrative decisions (e.g. court verdicts, court rulings, court-ratified mediation agreement, or administrative decisions). The ISP will be subject to joint liabilities if it fails to comply with the aforesaid request within reasonable time.
- **Newly established open licensing system (Amended Art. 50 and 51)** – The patentee can grant an open license of a patent to any entity or person by registering a written declaration at the CNIPA. The conditions and means to pay the open license fee must be standardized. The patentee is allowed to withdraw the open license, but it will not impact the effectiveness any open license granted before the withdrawal. Any entity or person can obtain the open license by sending a written notice to the patentee and paying the standardized license fee. No exclusive or sole license can be granted for the same patent during the effective period of an open license.
- **Domestic priority right for design patents (Amended Art. 30)** – The applicant can claim priority right for a design patent application if it has filed another design patent application with the same subject matter in China within six month before the latter filing.



- **Extended protection period for design patents (Amended Art. 43)** – The protection period for design patent has been extended from ten years to fifteen years.
- **Highly generalized rule on abuse of patent right (Amended Art. 20)** – The patentees is forbidden to abuse its patent right to harm the public interests or the lawful interests of others, or to exclude or limit competition. More detailed provisions regarding patent right abuse are expected to be described in subsequent implementation rules or judicial interpretations.

Attachment 1: Explanation to the Draft Amendment to the Patent Law of the People's Republic of China;

Attachment 2: Comparison Chart for the Fourth Draft Amendment to the Patent Law of the PRC

### 3. What is Different About Zhuhai's New QFLP Pilot Scheme?

Authors: James WANG | Li YANG | Zhiwei LIU | Yi XU

On January 7, 2019, the Zhuhai Financial Work Bureau (“**Zhuhai Financial Bureau**”) published on its official website the *Interim Measures for Administration of the Pilot Scheme for Foreign-invested Equity Investment Enterprises in Zhuhai* (“**Zhuhai QFLP Measures**”), and an article entitled *QFLP Pilot Scheme Officially Landing in Zhuhai Will Help to Build An International Industry and Venture Capital Highland* to briefly introduce the background, main content, characteristics and goals of the Zhuhai QFLP Measures. The release of the Zhuhai QFLP Measures indicates the official launch of the foreign-invested equity investment enterprise (commonly known as “**QFLP**”) pilot scheme in Zhuhai, and henceforth a clear guidance is made available to investors who desire to establish QFLP pilot enterprises in Zhuhai. The Zhuhai QFLP Measures stipulate that they will take effect 30 days following their issuance. We noticed that the Zhuhai Financial Bureau has already published the Zhuhai QFLP Measures on its website on December 21, 2018 before reposted the exact same document on January 7, 2019. Thus, the Zhuhai QFLP Measures will come into force as of January 20, 2019.

Since Shanghai<sup>5</sup> took the initiative to promulgate its QFLP pilot scheme in late 2010 and launched its QFLP pilot work in early 2011, multiple cities, including Beijing<sup>6</sup>, Tianjin<sup>7</sup>, Chongqing, Shenzhen<sup>8</sup>, Qingdao, Guizhou and Pingtan<sup>9</sup> (Fujian), have introduced QFLP pilot schemes to promote their respective local QFLP pilot work. To date, most of the said cities have implemented QFLP pilot schemes for several years and the results vary: some have successfully attracted quite a few of high-profile overseas private equity institutions which have successfully established and operated QFLPs therein, while some have already terminated their QFLP pilot schemes as the results fall short of expectations. In addition, some cities, including Shenzhen, have released new versions of their pilot schemes based on prior experience in order to achieve better results. Now, under the background of Chinese government’s vigorous promotion of the construction of the Guangdong-Hong Kong-Macao Greater Bay Area and great efforts to attract and retain foreign investments, by drawing on its geographic advantages of being adjacent to Hong Kong and Macao and relying upon prior experience, Zhuhai becomes the second city in Guangdong Province to implement a QFLP pilot scheme following Shenzhen. So, what are the main contents of the Zhuhai QFLP Measures? And what are the characteristics that distinguish the Zhuhai QFLP Measures from QFLP pilot schemes in

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<sup>5</sup> Regarding the Shanghai QFLP pilot scheme, please refer to the Han Kun newsletter article entitled “Summary of Recent Regulation Interpretation Seminar on Qualified Foreign Limited Partner (QFLP) Pilot Scheme in Shanghai”, dated April 28, 2011.

<sup>6</sup> Regarding the Beijing QFLP pilot scheme, please refer to the Han Kun newsletter article entitled “Introduction to Beijing QFLP Measures”, dated November 21, 2011.

<sup>7</sup> Regarding the Tianjin QFLP pilot scheme, please refer to the Han Kun newsletter article entitled “Introduction to Tianjin QFLP Interim Measures and Its Implementing Rules”, dated November 25, 2011; regarding comparisons of QFLP pilot schemes in Beijing, Shanghai and Tianjin, please refer to the Han Kun newsletter article entitled “Comparisons of QFLP Pilot Schemes in Beijing, Shanghai and Tianjin”, dated January 5, 2012.

<sup>8</sup> Regarding the 2013 Shenzhen QFLP pilot scheme, please refer to Han Kun's newsletter article entitled “Shenzhen Launches its QFLP Pilot scheme”, dated January 4, 2013; regarding the 2017 Shenzhen QFLP pilot scheme, please refer to Han Kun's newsletter article entitled “A Brief Overview of the Pilot Scheme for Foreign-funded Equity Investment Enterprises”, dated October 19, 2017.

<sup>9</sup> Regarding the Pingtan QFLP pilot scheme, please refer to the Han Kun newsletter article entitled “Analysis of the Pingtan, Fujian QFLP Pilot Scheme”, dated April 13, 2018.

other cities? In this article, we try to explore answers to those questions.

## I. Main Contents and Characteristics of the Zhuhai QFLP Measures

### A. Pilot Enterprises and the business scope

According to the Zhuhai QFLP Measures, pilot enterprises (“**Pilot Enterprises**”, each a “**Pilot Enterprise**”) include foreign-invested equity investment enterprises and foreign-invested equity investment management enterprises. Specifically, (i) foreign-invested equity investment management enterprises refer to the enterprises that the leading group for foreign-invested equity investment enterprise pilot work (the “**Leading Group**”) approves to establish in Zhuhai by foreign enterprises or individuals in accordance with the laws, to conduct the principal business of sponsoring or managing equity investment enterprises; and (ii) foreign-invested equity investment enterprises refer to enterprises that the Leading Group approves to set up in Zhuhai by foreign enterprises or individuals in accordance with the laws, to carry out the principal business of raising funds privately from domestic and/or offshore investors to invest in non-publicly traded corporate equities. The name of a Pilot Enterprise must include the words “equity investment management” or “equity investment”. Except the Pilot Enterprises approved the Leading Group, other Foreign-invested enterprises cannot include words “equity investment management” or “equity investment” in their names.

Zhuhai QFLP Measures are applicable to both foreign-invested equity investment enterprises and foreign-invested equity investment management enterprises established in Zhuhai. According to the Zhuhai QFLP Measures, both types of Pilot Enterprises are permitted to engage the following business activities, respectively:

Foreign-invested Equity Investment Enterprises	Foreign Invested Equity Investment Management Enterprises
<p>(1) Invest in domestic equities with proprietary funds within the scope permitted by the government, with the specific investment methods including the establishment of new enterprises, investment in established enterprises, purchase of equities from investors held in established enterprises and other methods permitted by national laws and regulations. (investments subject to special access administrative measures require government approval);</p> <p>(2) Provide management consulting to invested enterprises;</p> <p>(3) Other related businesses approved by the approval or registration authority.</p>	<p>(1) Sponsor the establishment of equity investment enterprises;</p> <p>(2) Manage the investment business activities of and provide related services to equity investment enterprises;</p> <p>(3) Provide equity investment consulting;</p> <p>(4) Other related businesses approved by the approval or registration authority;</p> <p>Foreign-invested equity investment</p>

Foreign-invested Equity Investment Enterprises	Foreign Invested Equity Investment Management Enterprises
<p>Foreign-invested equity investment enterprises shall invest in real economy industries and infrastructure projects conducive to the development of Guangdong-Hong Kong - Macao Greater Bay Area, or directly into the real economy sectors following the guidance of the <i>Catalog for the Guidance of Industries for Foreign Investment</i>. Fund of funds-model are prohibited (except for investments by strategic cooperative foreign-invested equity investment enterprises at or above the municipal level and investments in specific project funds that directly invest in real economy industries).</p>	<p>management enterprises cannot directly invest in specific investment portfolios.</p>

Under the QFLP pilot schemes promulgated by certain other cities (such as the abolished Shenzhen 2012 pilot scheme), the sole function of a foreign-invested equity investment management enterprise is to sponsor the establishment and to manage the foreign-invested equity investment enterprises. Accordingly, a foreign invested equity management enterprise is only permitted to raise funds from overseas institutional/individual investors (i.e., “FIE manager managing foreign capital” model), while a foreign-invested equity investment management enterprise is not allowed to raise funds from domestic investors to set up pure RMB funds (i.e., “FIE manager managing domestic capital”), and a domestic equity investment management enterprise is not permitted to raise funds from offshore investors to establish foreign-invested equity investment enterprises (i.e., “domestic manager managing foreign capital”). Under the Zhuhai QFLP pilot scheme, all three of these models -- “FIE manager managing foreign capital”, “FIE manager managing domestic capital” and “domestic manager managing foreign capital” -- are permitted.

## B. Entry thresholds for offshore investors

Under the Zhuhai QFLP pilot scheme, “FIE manager managing foreign capital,” FIE manager managing domestic capital” and “domestic manager managing foreign capital” are all allowed. Accordingly, there are two primary routes for offshore investors to participate in the QFLP pilot scheme. First, offshore investors solely or jointly with domestic institutions may establish foreign-invested equity investment management enterprises, which subsequently may raise funds from domestic and/or overseas investors to establish foreign/domestic equity investment enterprises to make equity investments (i.e., participate as a general partner). Secondly, offshore investors may invest in foreign-invested equity investment enterprises, and through which the investors may indirectly participate in domestic equity investments. In the latter case, the offshore investors themselves only act as passive investors in an equity investment enterprise but do not participate in the fundraising, management and investment operation of the enterprise (i.e., participate as a limited partner).

The Zhuhai QFLP pilot scheme, by reference to the provisions of the 2017 Shenzhen QFLP pilot

scheme, sets forth different entry requirements for the aforesaid two approaches in consideration of the significant differences in an investor’s involvement in the establishment and operation of QFLP Pilot Enterprises, as well as the undertaking of liability, which shows substantial differences compared to QFLP pilot schemes previously promulgated in some other cities (such as the abolished 2012 Shenzhen pilot scheme). The specific entry requirements for the two types of investors are as follows:

- a. Conditions for offshore investors to become a shareholder or partner of a foreign-invested equity investment management enterprise

Hong Kong and Macau Investors	Other Offshore investors
<p>Shall satisfy one of the following conditions:</p> <p>(1) In the fiscal year prior to application, possess proprietary assets (net assets) of not less than USD 6 million or equivalent, or assets under management (AUM) of not less than USD 12 million or equivalent; requirements for Macao enterprises or individuals may be lowered as appropriate, subject to examination and approval of the Leading Group on a “case-by-case” basis.</p> <p>(2) Hold an asset management license issued by the financial supervision and administration authority in the region where the investor is located.</p>	<p>Shall satisfy one of the following conditions:</p> <p>(1) In the fiscal year prior to application, possess proprietary assets (net assets) of not less than USD 100 million or equivalent, or assets under management (AUM) of not less than USD 200 million or equivalent.</p> <p>(2) Hold an asset management license issued by an overseas financial supervision and administration authority.</p>

- b. Conditions for offshore investors to become limited partners of a foreign-invested equity investment enterprise

Hong Kong and Macau Investors	Non-Hong Kong and Macao Offshore investors
<p>Shall meet the qualified investor requirements as provided in <i>Guiding Opinions of the People’s Bank of China, the China Banking and Insurance Regulatory Commission, the China Securities Regulatory Commission and the State Administration of Foreign Exchange on Regulating the Asset Management Business of Financial Institutions</i> (Yin Fa [2018] No. 106) and the <i>Interim Measures for the Supervision and Administration of Private Investment Funds</i> (CSRC Order No. [105]) and other provisions.</p>	

### C. Conditions for the establishment of Pilot Enterprises

Besides the requirements mentioned in above paragraph (2), offshore investors also need to meet other conditions to establish Pilot Enterprises to participate in the Zhuhai QFLP pilot scheme. The specific conditions for the establishment of the two types of Pilot Enterprises are briefly summarized

as follows:

a. Pilot conditions for establishing foreign-invested equity investment enterprises:

<b>Conditions for establishing foreign-invested equity investment enterprises:</b>		
Place of Registration	Must be registered in Zhuhai.	
Offshore shareholders/partners	<b>Hong Kong and Macau investors</b>	<b>Non-Hong Kong and Macao offshore investors</b>
	<p>Shall meet one of the following conditions:</p> <p>(1) In the fiscal year prior to application, possess proprietary assets (net assets) of not less than USD 6 million or equivalent, or assets under management (AUM) of not less than USD 12 million or equivalent; requirements for Macao enterprises or individuals may be lowered as appropriate, subject to examination and approval of the Leading Group on a “case-by-case” basis.</p> <p>(2) Hold an asset management license issued by the financial supervision and administration authority in the region where the investor is located.</p>	<p>Shall meet one of the following conditions:</p> <p>(1) In the fiscal year prior to application, possess proprietary assets (net assets) of not less than USD 100 million or equivalent, or assets under management (AUM) of not less than USD 200 million or equivalent.</p> <p>(2) Hold an asset management license issued by an offshore financial supervision and administration authority.</p>
(In the case of a joint venture jointly established by domestic and offshore investors) domestic shareholders/partners	<p>Shall satisfy one of the following conditions:</p> <p>(1) Be a commercial bank, securities company, insurance company, trust company, financial leasing company, public fund management company or other licensed financial institution approved by a national financial regulatory authority, or a first-tier subsidiary of a financial institution (in which case the financial institution shall control not less than 50% of such subsidiary);</p> <p>(2) Be an enterprise registered in Zhuhai and satisfy one of the following conditions: (i) in the fiscal year prior to application, possess proprietary assets (net assets) of not less than RMB 300 million, or have assets under management (AUM) of not less than RMB 500 million; or (ii) be profitable for the last three consecutive years (as a whole), with cumulative net profits of not less than RMB 60 million and cumulative tax payments of not less than RMB 18 million; or (iii) be a domestic or</p>	

<b>Conditions for establishing foreign-invested equity investment enterprises:</b>	
	foreign main board-listed enterprise or the controlling shareholder of such enterprise.
Senior officers	<p>Have at least two senior officers who meet the following conditions (directors, supervisors, general managers, deputy general managers, financial controllers, board secretaries of an incorporated enterprise or other officers as provided in the articles of association, or the general partners in a partnership or other officers as provided in the partnership agreement):</p> <p>(1) Have more than five years' experience engaging in equity investment or equity investment management;</p> <p>(2) Have served for more than two years as a senior management officer;</p> <p>(3) Have experience engaging in domestic equity investment or working for domestic financial institutions;</p> <p>(4) Have no record of regulatory violations in the past five years nor are subject to any pending economic dispute lawsuits and have maintained a good personal credit status.</p>
Registered capital / capital contribution	<p>The registered capital (subscribed capital contributions) shall be not less than USD 2 million or equivalent, and contributions are limited to currency. The registered capital (or subscribed capital contributions) shall be paid up to 20% or more within three months from the date of issuance of the business license, and the remaining shall be paid within two years from the date of establishment of the enterprise.</p>
Other conditions	<p>In view of the need for foreign-invested equity investment management enterprises to apply to AMAC to register managers as private fund managers, it is also necessary to satisfy all AMAC registration conditions (including but not limited to personnel, office premise, etc.).</p>

**b. Pilot conditions for establishing foreign-invested equity investment enterprises**

<b>Conditions for establishing <u>foreign-invested equity investment enterprises</u></b>	
Place of registration	Must be registered in Zhuhai.
General partner	Foreign-invested equity investment management enterprises and domestic-funded private equity and venture capital fund management enterprises that qualify under the provisions of Article 10 of the Zhuhai QFLP Measures shall act as general partners of the equity investment enterprises that they establish.
Limited	(1) All domestic and offshore limited partners shall meet the qualified investor

<b>Conditions for establishing <u>foreign-invested equity investment enterprises</u></b>		
partners (including domestic and foreign limited partners)	<p>requirements under the <i>Guiding Opinions of the People's Bank of China, the China Banking and Insurance Regulatory Commission, the China Securities Regulatory Commission and the State Administration of Foreign Exchange on Regulating the Asset Management Business of Financial Institutions</i> (Yin Fa [2018] No. 106), the <i>Interim Measures for the Supervision and Administration of Private Investment Funds</i> (CSRC Order No. [105]) and other related regulations.</p> <p>(2) Where the same person is the actual controller of a general partner and a limited partner in a foreign-invested equity investment enterprise, the capital contribution of that person to the enterprise cannot exceed 50%.</p>	
Registered capital / capital contributions	<b>Equity investment enterprises established by Hong Kong or Macao enterprises or individuals</b>	<b>Equity investment enterprises established by other offshore enterprises or individuals</b>
	Subscribed capital contributions of not less than USD 6 million or equivalent, contributions are limited to currency. Contributions shall be paid out of investor's proprietary assets and from legitimate fund sources.	Subscribed capital contributions of not less than USD 15 million or equivalent, contributions limited to currency. Contributions shall be paid out of the investor's proprietary assets and from legitimate fund sources.

#### **D. Entry thresholds for domestic institutions under the “domestic capital managing foreign investment” model**

As mentioned above, the Zhuhai QFLP Measures permits the model of “domestic manager managing foreign capital,” which means that a pure domestic fund management institution may raise funds from offshore investors to establish a foreign-invested equity investment enterprise. The conditions for domestic fund management institutions to participate in the establishment or the entrusted management of foreign-invested equity investment enterprises are clearly provided in the Zhuhai QFLP Measures. Specifically, these domestic fund management institutions should be institutional private equity or venture capital fund managers, and shall concurrently satisfy the following conditions:

- Such domestic fund management institution or its controlling shareholder shall be legally registered and established in China and shall have been registered with the AMAC for six months or more;
- For the previous fiscal year, such domestic fund management institution or its controlling shareholder shall possess proprietary asset (net assets) of not less than RMB 300 million or



assets under management (AUM) of not less than RMB 500 million;

- Such domestic fund management institution shall have being operating legally, has sound governance structures and internal controls, and for the preceding three years, has not been punished by the judicial authorities and relevant regulatory authorities, has not been entered into the National Enterprise Credit Information Publicity System List of Dishonest Enterprises Committing Serious Violations of Law or the AMAC's List of Non-reporting (Abnormal) Institutions.
- Such domestic fund management institution shall be registered in Zhuhai.

## **II. Comparison of Entry Conditions in Shenzhen and Zhuhai**

Zhuhai and Shenzhen are both located in the Guangdong-Hong Kong-Macao Greater Bay Area, and they have similar geographical characteristics as neighbors to Hong Kong and Macau. Compared with Zhuhai, Shenzhen introduced its QFLP pilot scheme as early as 2012 and then revised and issued a new version of the QFLP pilot scheme in 2017 based on its prior experience. A comparison of the provisions of Zhuhai's QFLP pilot scheme and the 2017 Shenzhen pilot scheme shows that there are many similarities, and we can infer that the formulation of the Zhuhai QFLP pilot scheme drew from the 2017 Shenzhen QFLP pilot scheme. However, the Zhuhai QFLP pilot scheme is also different from the Shenzhen QFLP pilot scheme in certain aspect. For example, with respect to the entry thresholds for offshore investors, the Zhuhai QFLP pilot scheme sets different conditions for Hong Kong and Macau investors and for other offshore investors (this point is similar to the previous QFLP pilot scheme introduced in Pingtan, Fujian). In addition, the Zhuhai QFLP pilot scheme is also based on practical considerations to appropriately reduce some threshold conditions compared to the Shenzhen QFLP pilot scheme, as follows:

Issue	2017 Shenzhen QFLP pilot scheme	Zhuhai QFLP pilot scheme
Entry conditions for offshore shareholders or partners of foreign-invested management enterprises	<p>Shall satisfy one of the following conditions:</p> <p>(1) In the fiscal year prior to application, possess proprietary assets (net assets) of not less than USD 100 million or equivalent or assets under management (AUM) of not less than USD 200 million or equivalent.</p> <p>(2) Hold an asset management license issued by the Hong Kong Securities Regulatory Commission (or other offshore financial regulatory authority).</p>	<p>Shall satisfy one of the following conditions:</p> <p>(1) In the fiscal year prior to application, Hong Kong and Macau investors shall have proprietary assets (net assets) of not less than USD 6 million or equivalent or assets under management(AUM) of not less than USD 12 million or equivalent; other offshore investors should have proprietary assets (net assets) of not less than USD 100 million or equivalent or assets under management(AUM) of not less than USD 200 million or its equivalent; to promote a moderate and diversified Macau economy, Macau enterprises or individuals may be subject to relaxed requirements by the Leading Group on a case-by-case basis based on specific circumstances.</p> <p>(2) Hold an asset management license issued by an offshore financial supervision and administration authority.</p>
Entry requirements for domestic shareholders or partners in foreign-invested equity management enterprises	<p>Shall satisfy one of the following conditions:</p> <p>(1) Be a commercial bank, securities company, insurance company, trust company, financial leasing company, public fund management company or other licensed financial institution approved by a national financial regulatory authority, or a first-tier subsidiary of a financial institution (in which case the financial institution shall control not less than 50% of such subsidiary);</p> <p>(2) Be a large-scale enterprise introduced and supported by the municipal communist party committee or</p>	<p>Shall satisfy one of the following conditions:</p> <p>(1) Be a commercial bank, securities company, insurance company, trust company, financial leasing company, public fund management company or other licensed financial institution approved by a national financial regulatory authority, or a first-tier subsidiary of a financial institution (in which case the financial institution shall control not less than 50% of such subsidiary);</p> <p>(2) <u>Be an enterprise registered in Zhuhai and satisfy one of the following conditions:</u> (i) in the fiscal year prior to application, have proprietary assets (net assets) of not less than <u>RMB 300 million</u>, or have assets under management(AUM) of not less than <u>RMB 500</u></p>

Issue	2017 Shenzhen QFLP pilot scheme	Zhuhai QFLP pilot scheme
	<p>government, and have proprietary assets (net assets) of not less than <u>RMB 500 million</u>, or have assets under management (AUM) of not less than <u>RMB 1 billion</u>; be profitable for the last three consecutive years (as a whole), with cumulative net profits of not less than RMB 60 million and cumulative tax payments of not less than RMB 18 million.</p>	<p><u>million</u>; or (ii) be profitable for the last three consecutive years (as a whole), with cumulative net profits of not less than RMB 60 million and cumulative tax payments of not less than RMB 18 million; or (iii) be a domestic or foreign main board-listed enterprise or the <u>controlling shareholder of such enterprise</u>.</p>
<p>Entry conditions for limited partners in foreign-invested equity investment enterprises</p>	<p>Concurrently satisfy the following conditions:</p> <ol style="list-style-type: none"> <li>(1) Be an institution or individual that possesses the corresponding ability to assess and bear risk;</li> <li>(2) With regard to institutional investors, they shall have sound governance structures and sound internal controls, and have not been punished by the judicial authority and relevant regulatory authorities in the country or region where the applicants are located in the past two years; offshore institutional investors shall possess net proprietary assets of not less than USD 5 million or equivalent and single investments that investors makes should not be less than USD 1 million or equivalent; domestic institutional investors should possess proprietary assets of not less than RMB 10 million and single investment that investors make should not be less than RMB 1 million.</li> <li>(3) With regard to Individual investors, they are required to</li> </ol>	<p>All limited partners shall meet the qualified investor requirements under the <i>Guiding Opinions of the People's Bank of China, the China Banking and Insurance Regulatory Commission, the China Securities Regulatory Commission and the State Administration of Foreign Exchange on Regulating the Asset Management Business of Financial Institutions</i> (Yin Fa [2018] No. 106), the <i>Interim Measures for Supervision and Administration of Private Investment Funds</i> (CSRC Decree No. 105) and other related regulations.</p>

Issue	2017 Shenzhen QFLP pilot scheme	Zhuhai QFLP pilot scheme
	<p>sign equity investment enterprise (fund) risk disclosure statements; and each domestic and offshore individuals shall possess financial assets of not less than RMB 3 million or annual incomes in the most recent three years of not less than RMB 500,000 and make single investments of not less than RMB 1 million.</p>	
<p>Conditions for the establishment of domestic institutions and the management of foreign-invested equity investment enterprises</p>	<p>Concurrently satisfy the following conditions:</p> <ol style="list-style-type: none"> <li>(1) Be a domestic enterprise legally registered and established in China;</li> <li>(2) Be a domestic private equity or venture capital investment fund management company registered for six months or more with the Asset Management Association of China;</li> <li>(3) During the entire preceding fiscal year, possess proprietary assets (net assets) of not less than RMB 500 million or manage assets of not less than RMB 1 billion;</li> <li>(4) Have sound governance structures and internal controls, and not have been punished by the judicial authorities and relevant regulatory authorities in the preceding three years;</li> <li>(5) Be registered in Shenzhen.</li> </ol>	<p>Concurrently satisfy the following conditions:</p> <ol style="list-style-type: none"> <li>(1) (such management institution or its controlling shareholder) Be a domestic enterprise legally registered and established in China, and have been registered with the Asset Management Association of China for six months or more;</li> <li>(2) (such management institution or its controlling shareholder) During the entire preceding fiscal year, possess proprietary assets (net assets) of not less than RMB 300 million or manage assets of not less than RMB 500 million;</li> <li>(3) Have been operating legally, have sound governance structures and internal controls, and have not been punished by the judicial authorities and relevant regulatory authorities in the preceding three years; not have been entered into the National Enterprise Credit Information Publicity System List of Dishonest Enterprises Committing Serious Violations of Law or the AMAC List of Out-of-Contact (Abnormal) Institutions.</li> <li>(4) Be registered in Zhuhai.</li> </ol>

### III. Operating Requirements

The Zhuhai QFLP Measures provide a series of specific requirements for the operation of Pilot Enterprises after their establishment:

#### A. Custodianship

According to the Zhuhai QFLP Measures, foreign-invested equity investment management enterprises shall entrust a commercial banking institution to be the fund custodian bank, and domestic RMB funds managed by a foreign-invested equity investment enterprise or a foreign-invested equity investment management enterprise shall entrust a commercial banking institution to be the project fund custodian bank. The custodian bank shall be a commercial bank at the branch level or above that is approved by the state financial supervision department and possesses the ability and qualifications to serve as a fund custodian. The custodian bank shall examine the authenticity and compliance of the use of funds within the escrow accounts of the Pilot Enterprise, and supervise the Pilot Enterprise to use capital within the escrow account within its business scope and in accordance with the law, make anti-fraud and anti-money laundering investigations at account settlement, and urge the Pilot Enterprise to pay relevant taxes and fees.

#### B. Registration and Filing

The Zhuhai QFLP Measures require Pilot Enterprises to go through the corresponding fund manager registration and fund filing procedures in accordance with the requirements of applicable regulations, and make clear requirements for the time limit for completion of registration and registration procedures. Specifically, all foreign-invested equity investment management enterprises should complete registration with the AMAC and establish the first foreign-invested equity investment enterprise or domestic private equity and venture capital fund within twelve months of obtaining the notice of determination. All foreign-invested equity investment enterprises or domestic private equity and venture capital funds established will complete filing with the AMAC within six months of establishment. If any Pilot Enterprise fails to complete fund manager registration and fund filing procedures within the prescribed time, the Leading Group will cancel the enterprise's qualifications to participate in the pilot scheme, make a public announcement of the cancellation and order the enterprise to go through deregistration formalities within 90 days.

#### C. Examination and Approval of Changes

According to the Zhuhai QFLP Measures, a Pilot Enterprise needs to obtain a notice of determination of the Zhuhai Financial Bureau before processing the registration amendment procedures with AIC if it intends to change its registration items, such as the company's articles of association (or partnership agreement), company name, legal representative (or executive partner or its representative), senior management, shareholders (or partners) or registered address. Therefore, a pilot equity investment enterprise should first submit the relevant application materials to the Zhuhai Financial Bureau if it needs to increase the number of limited partners or increase subscribed capitals of the existing limited partners. In case of admission of any new partner, the enterprise also needs to submit a certification document proving that the new limited partner meets the entry conditions.

#### D. Reporting of significant events

According to the Zhuhai QFLP Measures, Pilot Enterprises shall report to the Zhuhai Financial Bureau every six months any of the following significant events that has occurred in the course of investment operations during the preceding six months.

- Operation of investment projects;
- Modify important legal documents such as articles of association or partnership agreements;
- Other events as required by Zhuhai Financial Bureau.

The custodian bank of the Pilot Enterprise shall be responsible for matters including but not limited to:

- Within ten business days after the end of each quarter, report to the Leading Group Office and the relevant units of the Leading Group about information related to the operation of the escrow funds and the status of investment projects of the Pilot Enterprise for the previous quarter.
- Within 15 business days after the end of each fiscal year, submit to the office of the Leading Group and the relevant units of the Leading Group an annual report on the domestic equity investments of the Pilot Enterprise for the previous year that has been approved by all parties.
- Supervise the investment operation of the Pilot Enterprises and refuse to implement and report immediately to the Zhuhai Financial Bureau if it finds the investments of the Pilot Enterprise violate the laws and regulations or custody agreements;
- Other supervisory duties as stipulated by the Leading Group.

#### **E. Exit approval**

According to the Zhuhai QFLP Measures, a Pilot Enterprise may make profit distributions, liquidate and exit from investments in accordance with the company's articles of association or partnership agreements. A Pilot Enterprise needs to submit the relevant tax payment certificates or tax filing forms to the custodian bank and seek approval from the custodian bank if it intends to remit offshore the profits, dividends and/or bonuses.

## **IV. Summary**

Since the launch of the QFLP pilot in Shanghai in early 2011, many cities have introduced their own QFLP pilot schemes to promote the implementation of QFLP pilot work, aiming to attract prestigious investment institutions and to promote the development of the local equity investment industry. Zhuhai launched QFLP pilot scheme several years later than some of its counterparts, therefore lost some opportunities, but in turn Zhuhai has an advantage of drawing lessons from the experiences of previous pilot schemes. The Zhuhai QFLP pilot scheme has a clear position that runs throughout the entire text, which is to support the moderate diversification of the Macao economy, and provide a convenience for Hong Kong and Macao investors to set up Pilot Enterprises in Zhuhai. We believe the promulgation of the Zhuhai QFLP pilot scheme will help Zhuhai to attract more offshore investors (especially Hong Kong and Macao investors) to participate in the domestic equity investment industry development in the future.<sup>10</sup>

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<sup>10</sup> Regarding the common schemes and related oversight on overseas funds participating in domestic equity investment, please refer to Han Kun's newsletter article entitled "How Does Overseas Capital Participate in Domestic Equity Investment? - FDI, QFLP/R-QFLP & More", dated September 5, 2018.

## 4. New Master Agreements Issued for Securities Derivatives

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On December 27, 2018, the Securities Association of China (SAC), the China Futures Association (CFA) and the Asset Management Association of China (AMAC) jointly issued the *Notice on Issuing the Master Agreement for Derivatives Transactions in the China Securities and Futures Markets*<sup>11</sup>. The name of the *Master Agreement for OTC Derivatives Transactions in the China Securities and Futures Markets (2014 Version)* (the “**2014 Master Agreement**”) has now been changed to the *Master Agreement for Derivatives Transactions in the China Securities and Futures Markets* (the “**2018 Master Agreement**”). On the same day, the three associations above, the Shanghai Stock Exchange and the Shenzhen Stock Exchange jointly issued the *Master Agreement for Derivatives Transactions in the China Securities and Futures Markets (Special Version for Credit Protection Contracts)* (the “**SV Master Agreement**”) <sup>12</sup>, which was formulated for the purpose of standardizing credit protection transactions within the exchanges.

### I. The Master Agreement for Derivatives Transactions in the China Securities and Futures Markets

In order to manage the OTC derivatives business in the securities industry, SAC issued on March 13, 2018 the *Master Agreement for Financial Derivatives Transactions in the China Securities Market (2013 Version)* (the “**2013 Master Agreement**”) and its supplement, the *Norms for OTC Financial Derivatives Transactions of Securities Companies* and the *Guidelines for Risk Management of OTC Financial Derivatives Transactions of Securities Companies*. These rules act to regulate OTC derivatives business in the securities industry and require securities companies to file 2013 Master Agreements with SAC upon signing<sup>13</sup>.

On August 22, 2014, to resolve issues relating to OTC derivatives transactions across different markets, SAC, CFA and AMAC jointly issued the 2014 Master Agreement and its supplement, which was revised on the basis of the 2013 Master Agreement. The 2014 Master Agreement extended its applicable scope from securities market to funds and futures markets, and securities companies, fund management companies and futures companies filed 2014 Master Agreements and their supplements with their respective associations upon signing<sup>14</sup>.

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<sup>11</sup> The *Notice on Issuing the China Securities and Futures Markets Derivatives Transaction Master Agreement*  
Please see [http://www.sac.net.cn/tzgg/201812/t20181227\\_137451.html](http://www.sac.net.cn/tzgg/201812/t20181227_137451.html)

<sup>12</sup> The *Notice on Issuing the China Securities and Futures Markets Derivatives Transaction Master Agreement (Special Version for Credit Protection Contracts)*  
Please see [http://www.sac.net.cn/tzgg/201812/t20181227\\_137452.html](http://www.sac.net.cn/tzgg/201812/t20181227_137452.html)

<sup>13</sup> The *Notice on Issuing the China Securities Market Financial Derivatives Transaction Master Agreement (2013 Version) and Relevant Self-Regulatory Rules*  
Please see [http://www.sac.net.cn/tzgg/201303/t20130315\\_61883.html](http://www.sac.net.cn/tzgg/201303/t20130315_61883.html)

<sup>14</sup> The *Notice on Issuing the China Securities and Futures Markets OTC Derivatives Transaction Master Agreement (2014 Version)* and the *China Securities and Futures Market OTC Derivatives Transaction Equity Derivatives Definition Document (2014 Version)*  
Please see [http://www.sac.net.cn/tzgg/201408/t20140822\\_102261.html](http://www.sac.net.cn/tzgg/201408/t20140822_102261.html)

Four years later, SAC, CFA and AMAC changed the name of the *Master Agreement for OTC Derivatives Transactions in the China Securities and Futures Markets (2014 Version)* to the *Master Agreement for Derivatives Transactions in the China Securities and Futures Markets*. The 2018 Master Agreement applies to OTC derivatives other than credit protection transactions, which means that the new master agreement will not apply to credit protection transactions. Credit protection transactions will instead be governed by the SV Master Agreement. In addition, SAC has also provided for transitioning from the 2014 Master Agreement to the 2018 Master Agreement. According to SAC, any previously signed 2014 Master Agreements and their supplements will continue to be effective. The 2018 Master Agreements and their supplements shall be signed by the counterparties when conducting new securities and futures markets derivatives transactions (excluding credit protection transactions).

Currently China does not have unified supervision of OTC derivatives business, nor has it formulated any unified laws or regulations for OTC derivatives transactions. As a result, there are currently two sets of master agreements existing in the market which govern derivatives transactions. Besides the 2018 Master Agreement, the National Association of Financial Market Institutional Investors (NAFMII) also issued in 2009 the *NAFMII Master Agreement (2009 Version)* (the “**NAFMII Master Agreement**”). When SAC issued the 2013 Master Agreement, the association stated that it would co-operate with NAFMII on master agreements for derivatives transactions, share experiences and formulate a unified master agreement with NAFMII to govern financial derivatives transactions.<sup>15</sup> However, such plans have not yet been implemented. In market practice, banking financial institutions generally sign a NAFMII Master Agreement with their counterparties for derivative transactions, while securities companies, fund management companies, futures companies and other institutions have generally signed the different versions of the SAC-issued master agreement.

## **II. The Master Agreement for Derivatives Transactions in the China Securities and Futures Markets (Special Version for Credit Protection Contracts)**

The SV Master Agreement is a new master agreement to govern derivative transactions which has been jointly launched by the three associations and the two exchanges based on the 2014 Master Agreement. Compared with the 2014 Master Agreement, there are some minor adjustments in the SV Master Agreement, such as extended notice and grace periods for the performance of agreements. In addition, the SV Master Agreement also adjusts and refines terms regarding payment currency, events of default (or potential events of default), termination events, governing law and dispute resolution, and delivery of notices, etc.

The most notable difference between the SV Master Agreement and the 2014 Master Agreement is that the SV Master Agreement generally does not allow for the transfer of any rights or obligations under the agreement. Exceptions to these transfer restrictions include rights to payment in case of default or early termination and certain other related rights to payment, such as interest, compensation and expenses. In addition, the SV Master Agreement specifies that both parties to the transaction will timely file with SAC a

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<sup>15</sup> The *Statement on Issuing the Financial Derivatives Transaction Master Agreement and Relevant Rules*  
Please see [http://www.sac.net.cn/tzgg/201303/t20130315\\_61882.html](http://www.sac.net.cn/tzgg/201303/t20130315_61882.html)



signed SV Master Agreement and its supplement (including modifications, if any), which means the filing of SV Master Agreements is only to be conducted with SAC. Correspondingly, on December 27, 2018, SAC also issued the *Guidelines for Record-Filing of the Master Agreement for Derivatives Transactions in the China Securities and Futures Markets (Special Version for Credit Protection Contracts)*<sup>16</sup>, stipulating the relevant record-filing procedures.

According to the official introduction provided by SAC<sup>17</sup>, “a credit protection contract is an innovative financial derivative which is negotiated and agreed between the two parties to the transaction. During the agreed period, the credit protection seller shall bear the relevant credit risk associated with the reference entity, the specific type of debts and other debts with the features of debt, and periodically charge the credit protection buyer a protection fee in accordance with the contract. Upon the occurrence of any credit event or event of default, the credit protection seller shall compensate the credit protection buyer according to the terms of the contract.” In addition, the NAFMII-issued *Business Guidelines for Credit Risk Mitigation Contracts*<sup>18</sup> also state that “a credit risk mitigation contract refers to an agreement reached between both parties to the transaction, in which the credit protection buyer shall pay a credit protection fee to the credit protection seller in accordance with the agreed standards and methods within a certain period of time in the future. It is a financial contract under which the credit protection seller provides credit risk protection to the credit protection buyer for the agreed underlying debt, which belongs to a contractual credit risk mitigation instrument.” Based on the above descriptions, it can be observed that credit protection contracts are similar to the credit risk mitigation contracts introduced by NAFMII. There are also no substantial differences between the two contracts and credit default swaps (CDS) outside China, all of which are derivative instruments that provide protection against the default risk of underlying assets. The release of the SV Master Agreement may be similar to the co-existence of the NAFMII Master Agreement and the 2018 Master Agreement. This means that the SV Master Agreement may govern risk mitigation instruments offered in the securities exchange markets, while risk mitigation contracts signed in the interbank market may be governed by the NAFMII-issued *Business Guidelines for Credit Risk Mitigation Contracts*.

### **III. Can credit protection contracts solve the financing difficulties of private enterprises?**

On November 1, 2018, Chinese President Xi Jinping gave an important speech at a forum of private enterprises in which he highlighted the importance of solving the financing difficulties of private enterprises<sup>19</sup>. In response, on November 2, 2018, the Shanghai Stock Exchange launched a pilot

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<sup>16</sup> The *Notice on Issuing the Guidelines for Record-Filing of China Securities and Futures Markets Derivatives Transaction Master Agreement (Special Version for Credit Protection Contracts)*

Please see [http://www.sac.net.cn/tzgg/201812/t20181227\\_137454.html](http://www.sac.net.cn/tzgg/201812/t20181227_137454.html)

<sup>17</sup> The Securities Association of China (SAC) Takes the Lead in Issuing the Master Agreement for Credit Protection Contracts to Help Private Enterprises to Solve Financing Difficulties through Issuing Bonds

Please see [http://www.sac.net.cn/ljxh/xhgzt/201812/t20181227\\_137453.html](http://www.sac.net.cn/ljxh/xhgzt/201812/t20181227_137453.html)

<sup>18</sup> The *Business Guidelines for Credit Risk Mitigation Contracts* issued by the National Association of Financial Market Institutional Investors (NAFMII)

Please see [http://www.nafmii.org.cn/zlgl/xyfx/ywgz/201609/t20160926\\_57199.html](http://www.nafmii.org.cn/zlgl/xyfx/ywgz/201609/t20160926_57199.html)

<sup>19</sup> Chinese President Xi Jinping's Speech at a Forum of Private Enterprises

program for credit market protection instruments under which the first credit protection contracts have been successfully concluded. Guotai Junan Securities Co., Ltd (“**Guotai Junan Securities**”) and CITIC Securities Co., Ltd. (“**CITIC Securities**”) became the first batch of credit protection sellers, and concluded two credit protection contract transactions, with reference entities including private enterprises of different credit ratings, namely HongShi Holding Group Co., Ltd. and JCHX Mining Management Co., Ltd. Guotai Junan Securities and CITIC Securities also acted, respectively, as the lead underwriters of the corporate bonds issued recently by these two private companies<sup>20</sup>. In addition, the Shenzhen Stock Exchange also launched its first pilot program for credit protection instruments, with a notional amount of approximately CNY130 million. The reference entities are Suning Appliance Group Co., Ltd. and Zhejiang Hengyi Group Co., Ltd.<sup>21</sup>.

The issuance of the SV Master Agreement demonstrates the supportive attitude of Chinese regulators regarding credit protection transactions, and provides a new risk mitigation instrument for financial markets. The introduction of credit protection contracts may, to some extent, bring positive elements to the bond market in China. However, the question remains whether this action can effectively solve the financing difficulties of private enterprises in the future. We will continue to monitor these developments and observe their long-term effects.

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Please see [http://www.xinhuanet.com/politics/2018-11/01/c\\_1123649488.htm](http://www.xinhuanet.com/politics/2018-11/01/c_1123649488.htm)

<sup>20</sup> The Shanghai Stock Exchange Launches Pilot Program for Credit Protection Instrument to Support Bond Financing for Private Enterprises

Please see [http://www.sse.com.cn/home/apprelated/news/c/c\\_20181102\\_4671285.shtml](http://www.sse.com.cn/home/apprelated/news/c/c_20181102_4671285.shtml)

<sup>21</sup> The Shenzhen Stock Exchange Launches its First Pilot Program for Credit Protection Instrument to Improve the Efficiency of Bond Financing of Private Enterprises

Please see [http://www.szse.cn/aboutus/trends/news/t20181102\\_557319.html](http://www.szse.cn/aboutus/trends/news/t20181102_557319.html)

## ***Important Announcement***

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