



HAN KUN LAW OFFICES

# Legal Commentary



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## Private Equity Law

### Summary of Recent Regulation Interpretation Seminar on Qualified Foreign Limited Partner (QFLP) Pilot Program in Shanghai

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In order to further standardize the implementing procedures for the newly established qualified foreign limited partnership pilot program (“QFLP Pilot Program”) in Shanghai, clarify relevant procedures and responsibilities of various relevant authorities and accelerate the construction of Shanghai as an international financial center, Shanghai Financial Services Office, Shanghai Municipal Commission of Commerce and Shanghai Administration for Industry and Commerce, in reference with the qualified foreign institutional investor (“QFII”) regime for the stock market, jointly promulgated *the Implementation Measures on the QFLP Pilot Program in Shanghai* (the “QFLP Implementation Measures”) (you may find our detailed interpretation on the QFLP Implementation Measures in *Han Kun Newsletter* (Vol. 2011.01)). Recently, Shanghai Financial Services Office hosted a regulation interpretation seminar on the QFLP Pilot Program in Shanghai. Together with relevant officials from the Shanghai Branch of State Administration of Foreign Exchange (“SAFE”) and Shanghai Administration for Industry and Commerce (“AIC”), they clarified relevant issues in the QFLP implementation measures and the QFLP Pilot Program and analyzed the current status and future direction of the QFLP Pilot Program. Members of our Fund Formation & Management Group attended the regulation interpretation seminar and had in-depth discussions with relevant officials. The following is a summary of the seminar and our discussion with them:

■ **Current status on QFLP Pilot Program:**

- The aforesaid relevant authorities have created implementing regulations and pilot procedures regulating the custody of QFLP pilot enterprises, foreign exchange settlement, capital repatriation and information reporting. A detailed operations manual has been created (we have obtained such manual and other relevant QFLP application materials, which we will be made available to you upon request);
- The aforesaid relevant authorities have started the preliminary review of QFLP pilot enterprises. As of March 18, 2011, Carlyle/Fosun, Blackstone and DT Capital have been approved as QFLP pilot enterprises.

■ **Area of Focus for Future QFLP Application Review:**

- The approved QFLP pilot enterprises to date are mostly large buyout funds. In the next phase, the examination and approval authorities will seek to diversify the applicant base by selecting different types of QFLP pilot enterprises --- in addition to large buyout funds, they would also like to attract funds focused on investing in technology, entrepreneurial and employment-based SMEs with a high growth rate.
- It is hoped that the QFLP Pilot Program will spur a large amount of domestic private capital and help nurture domestic long-term investors.

■ **The Premise of Applications for the Pilot Policy:**

- The QFLP applicant must be a Shanghai-registered equity investment management enterprise ("EIME") or another type of Shanghai-registered investment management enterprise primarily engaged in the business of equity investment (mostly venture capital investment management enterprise, or "VCIME").
- Investors are clearly identified and the management team is in place. The investors have issued contribution commitment letters and letters of confirmation.

■ **Certain Key Considerations in Review of QFLP Applications for the Pilot Program:**

- The fund management team's investment experience in China, especially successful experience of exit;
- Priority given to enterprises with participation from domestic capital such as government guidance funds, state-owned enterprises and domestic non-state-owned enterprises;
- Priority given to enterprises investing in new industries with management teams that have prior experience in such industries;

- Preferred enterprises shall have a clear organizational structure, clear contribution of capital, clear investment plans and a market mechanism of governance structure and profits allocation / incentive system.

■ **Status of Establishment:**

- As of March 18, 2011, a total of 53 foreign-invested equity investment enterprises (“EIEs”) and EIMEs have been established; two of these are foreign-invested EIEs (with a total amount of registered capital of \$140 million), and the other 51 are foreign-invested EIMEs;

- *Shanghai Administration for Industry and Commerce’s Several Comments of Positive Support on Enterprises’ Innovation-driven and Restructuring Development* promulgated in February revealed important policies about the QFLP Pilot Program:

- ◆ Permitting qualified PRC individuals to establish Sino-foreign equity joint ventures and cooperative enterprises;

- ◆ Permitting the business and operation scope of equity investment enterprises and equity investment management enterprises to be described separately as “equity investment”/“equity investment fund” and “equity investment management”/“equity investment fund management”. This is a breakthrough to the limitations of enterprises’ name regulated in *Notice on Business Registration and Relative Matters of Equity Investment Enterprises in Shanghai* promulgated in August 2008, in which such enterprises’ name are not permitted to reference the word “fund”.

- ◆ According to actual needs, permitting names of certain qualified equity investment enterprises and equity investment management enterprises’ to have a suffix of “Fund I”, “Fund II”, “Fund III” and so on to better promote such enterprises’ brands as intangible asset.

- ◆ Permitting EIEs and EIMEs with management responsibility to share the same business address.

■ **Status of Foreign-invested Equity Investment Partnership and Its Portfolio Company.**

Officials from Shanghai Municipal Commission of Commerce interpreted the regulations regarding “foreign-invested partnership enterprises with the main business of investment shall be treated as foreign investors” in the *Notice on Issues about Foreign Investment Management* promulgated by Ministry of Commerce in 2011 (the “Notice”). The officials indicated that the Notice defined the status of the foreign-invested equity investment

partnership more clearly --- such enterprises are deemed foreign investors and not foreign-invested enterprises (“FIEs”). This treatment is similar to that of the other two types of investment enterprises with foreign participation --- foreign-invested investment companies and foreign-invested venture capital investment enterprises. China adopts an independent and relatively liberal regulatory regime on domestic reinvestments by foreign-invested enterprises, compared to that of foreign investors. Pursuant to relevant laws and regulations, when an FIE invests in China, if the target investment falls in the “encouraged” category or “permitted” category according to *the Catalogue of Industries for Guiding Foreign Investment*, the examination and approval procedure by the Ministry of Commerce (or its local counterpart) is not required and only registration with the Administration for Industry and Commerce is required; the approval from the Ministry of Commerce (or its local counterpart) is required only when the investment involves a “restricted” category. If it is treated as a foreign investor, then the full-blown foreign-investment examination and approval process is required regardless of the category of investment. Since foreign-invested equity investment partnership funds are expressly defined as foreign investors, prior to its domestic listing, a portfolio company of such funds will need to be converted to foreign-invested joint stock company pursuant to *the Interim Provisions on Several Issues about the Establishment of the foreign-invested Incorporated Corporation* promulgated in 1995, including the requirement of profitability for three consecutive years prior to the listing.

- **Industry entry.** In addition, for the first time, the Notice referenced equity investment from an industry entry perspective, indicating that the Ministry of Commerce has recognized foreign equity investment industry as an industry permitted for foreign investment.
- **Foreign Exchange Management.** QFLP enterprises are permitted to use foreign currency capital to make equity investments in China. QFLP enterprises are permitted to apply for foreign exchange registration and account and to make investments with RMB settled from foreign currency capital; provided that foreign exchange settlement may be conducted only when there is a specific investment project. The advantage of QFLP is that, once a QFLP pilot enterprise is approved, its manager may give direct orders to its custodian bank to settlement foreign exchange and transfer the funds to the recipient in one step without the review and approval by the State Administration of Foreign Exchange on a project by project basis. The officials from State Administration of Foreign Exchange also cleared rumors about the foreign exchange quota of US\$3 billion for the Shanghai Pilot Program and indicated that such foreign exchange quota does not exist.

- *Understanding Article 24 of the Pilot Measures.* It provides that “the QFLP that is approved to participate in the Pilot Program can use foreign currency capital to make capital contribution to the equity investment enterprise established by it. However, the amount of foreign currency capital shall not exceed 5% of the total fund raised, which capital contribution will not affect the original status of the equity investment enterprise in which the QFLP invests.” We understand that, within the 5% investment limit, Article 24 exempts QFLP pilot enterprises from the restrictions imposed by *the Notice of the General Affairs Department of the State Administration of Foreign Exchange on the Relevant Operating Issues concerning the Improvement of the Administration of Payment and Settlement of Foreign Currency Capital of Foreign-funded Enterprises* (Circular 142) promulgated by the SAFE on equity investment using funds with the settlement of foreign currency capital. Moreover, the investment in funds within the above 5% limit will not affect the original status of the equity investment enterprise that the QFLP invests in, that is, where there is no foreign limited partner, even if the general partner is a foreign-invested enterprise, it does not affect the domestic status of the fund.
  
- Relevant government officials also cleared rumors that the foreign currency capital portion of the registered capital of a QFLP pilot enterprise is capped at 50%. They indicated that there is no mandatory cap on the proportion of foreign currency capital for a QFLP pilot enterprise (theoretically, the QFLP pilot enterprise may be comprised solely of foreign currency capital); however, when reviewing applications for the Pilot Program, the domestic capital participation (especially the participation of guidance funds, state-owned enterprises and other state-owned entities) will be viewed favorably. (Please refer to *Certain Key Factors for the Review of QFLP Applications for the Pilot Program* above for more information.)

*The Notice of the General Office of the National Development and Reform Commission on Further Regulating the Development of Equity Investment Enterprises in Pilot Regions and the Relevant Record-filing Administration* promulgated this year requires the mandatory record-filing of equity investment enterprises established in designated pilot regions (including Shanghai) in excess of RMB500 million. With regard to the coordination of the aforesaid mandatory record-filing requirement and the requirements regarding record-filing in the QFLP Pilot Measures, relevant government officials indicated that the Pilot Measures promulgated in Shanghai, as local policies, shall be able to conform to relevant rules promulgated by the central government easily and that such matter shall be the primary responsibility of the government and should not be a main concern for QFLP pilot enterprises.

Should you have any questions regarding the above, please do not hesitate to contact us.

## Important Announcement

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

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