漢坤律師事務所
HAN KUN LAW OFFICES

Newsletter

12th Edition of 2012

Insights & Ideas

Legal Updates

Analysis of the New PRC Securities Investment Funds Law (Authors: James WANG, Evan ZHANG, and Sheldon CHEN)

On December 28, 2012, *The Law of the People's Republic of China on Securities Investment Funds (Revised in 2012)* (the "**2012 Securities Investment Funds Law**") was ratified after three rounds of review by the Standing Committee of the National People's Congress, and shall come into effect on June 1, 2013. The revision of *the Law of People's Republic of China on Securities Investment Funds Law* effective on June 1, 2004(the "**2004 Securities Investment Funds Law**") was finally completed, which lasted for three years and lead to intense debates within the industry. The following contains a brief introduction regarding the major revisions made to the 2004 Securities Investment Funds Law:

Deregulate and Standardize Publicly Raised Funds

1) Relax the Regulations and Restrictions on Publicly Raised Funds

The present administrative controls and restrictions on the operation of publicly raised funds have been seriously constraining the competitiveness and vitality of the fund market, thus making its current provisions no longer able to satisfy the rapid growth of fund markets and investors' needs. The 2012 Securities Investment Funds Law was created to moderately loosen the restrictions on the investment and operation of the publicly raised funds through the following points.

First, the "approval system" for public fund raising has been replaced with a "registration system." According to the 2012 Securities Investment Funds Law, a party who intends to publicly raise capital for a fund shall go through registration procedures with the securities regulatory authority under the State Council (the "**SRA**"). Compared to the "approval system," the "registration system" simplifies burdensome administrative application materials and procedures, making the new system more effective. This change reflects the intention of the regulatory authority to deregulate fund market entry.[1]

Second, the scope of investment for publicly raised funds has been expanded. According to the

[1] To simplify the report and review process for fund products, the Chinese Securities Regulatory Commission (the "**CSRC**") has issued the Notice on Issues concerning the Further Reform of the Fund Approval System to fund companies, specifying that the online operation of the Fund Products Internet-based Reporting and Review System ("**FIRST**") shall officially be commenced on January 1, 2013, when applying for fund raising, fund companies shall submit application materials in relation to fund raising through the FIRST system while submitting written materials to relevant department of the CSRC. When adopting the online reporting system for fund products, the review of normal fund products shall be completed within 20 working days under the summary procedure, and the classified supervision mechanism shall be applied to restrain the dishonest behaviors of the fund companies. If a fund company is to be found in the process of materials reporting to have submitted incomplete materials, or have not finished the product preparation work, or have massive misreporting, underreporting or other dishonest behaviors, the common review procedure shall be applied to the review for all fund products that is reported by that company thereafter.

2012 Securities Investment Funds Law, the scope of investment for fund assets has been expanded to include derivative securities prescribed by the SRA, which signifies the establishment of a legal basis for the funds to invest in currency markets, stock indexes, futures, and any other kind of derivative securities products.

Moreover, the restriction on the investment activities of the funds has been moderately relaxed. The 2004 Securities Investment Funds Law specifies that "the fund assets shall not be used for extending loans or securities to other persons." However, according to the 2012 Securities Investment Funds Law, extending loans or securities to other persons with fund assets in violation of applicable provisions is prohibited. In other words, loans or securities can be extended to other persons to the extent that the applicable provisions are not violated. In addition, the 2012 Securities Investment Funds Law has removed "using the fund assets to deal in the shares or bonds that are issued by the fund manager or the fund custodian" from the list of prohibited investment activities.

2) Standardize the Supervision over Publicly Raised Funds

Rapid development of the capital market and diversification of the financial products has raised the requirements for fund supervision. The 2012 Securities Investment Funds Law has placed the shareholders and the actual controller of the fund manager under regulatory supervision, and has stipulated the following provisions to regulate the governance structure of the funds.

First, it's specified that fund managers and their practitioners are explicitly prohibited from engaging in insider trading. According to the 2012 Securities Investment Funds Law, fund managers and their practitioners shall not: (1) encroach on or misappropriate fund assets, (2) divulge non-public information obtained by virtue of their positions, (3) engage in trading activities related to such information, or explicitly or implicitly ask others to engage in related trading activities.

Second, it is clarified that the shareholding structure and the governance structure of the fund management company are required to be stable. According to the 2012 Securities Investment Funds Law, on one hand, a fund management company is required to submit an application to the SRA for approval in the event that it intends to change shareholders who hold more than 5% of its equity or its actual controller. On the other hand, the shareholders or actual controller of a fund management company shall not make false capital contributions or withdraw capital contributions without undergoing required procedures, shall not bypass the shareholders' meeting and the board of directors to directly intervene in the daily operations of a fund manager, and shall not require fund managers to use fund assets to obtain benefits for it or other persons, which could jeopardize the interests of the holders of fund units.

Moreover, it is clarified that the SRA may order the fund manager to replace its directors, supervisors, or senior managers under certain circumstances. According to the 2012 Securities Investment Funds Law, where the directors, supervisors, or senior managers of a fund management company failed to perform their duties diligently and duteously, and caused the company to commit

grave violations of laws or regulations or to have major risks, the SRA may order the fund management company to replace the relevant personnel.

Bring Non-Publicly Raised Funds into Supervision

The development of non-publicly raised funds is significant in promoting economic restructuring, relieving the difficulty of financing faced by small and medium sized enterprises, etc. Notwithstanding, the Securities Fund Investment Law does not provide any regulation on non-publicly raised funds, and due to the absence of an explicit legal basis for and effective supervision over the establishment and operation of non-publicly raised funds, the infringement of investors' interest occurs from time to time. In order to effectively regulate non-publicly raised funds, the 2012 Securities Investment Funds Law has created a chapter discussing the non-publicly raised funds.

1) Establish a Record-Filing System for Non-Publicly Raised Funds

Once the capital raising for a non-publicly raised fund is completed, the fund manager shall report the information to the fund industry association for record-filing. In the event that the total amount of capital raised by a fund reaches the proscribed threshold, or the number of fund unit holders within a fund reaches the proscribed threshold, the fund industry association shall report the relevant information to the SRA. In contrast to the record filing system for private equity investment enterprises that is provided under the Notice of the General Office of the National Development and Reform Commission on Promoting the Standardized Development of Equity Investment Enterprises, the record-filing system under the 2012 Securities Investment Funds Law focuses on fund product record-filing. This means that the fund managers do not need to establish an entity (a company or limited partnership enterprise) for capital raising. However, some practical issues of the fund product record-filing system remain to be dealt with, such as account opening.

2) Establish a Qualified Investors System

Non-publicly raised funds shall only raise capital from qualified investors, and the number of such qualified investors shall not exceed 200 on an accumulative basis. The qualified investors shall refer to the entities and individuals that possess the required asset size or income level, have the appropriate risk identification capabilities as well as risk tolerance, and subscribe for fund units in an amount not lower than the prescribed minimum amount. The specific criteria of qualified investors shall be formulated by the SRA. However, for the purpose of calculating the number of investors, it remains to be clarified whether the ultimate investors of the funds of funds, collective fund trusts, and other institutions without legal person status shall be counted in the total number. Meanwhile, non-publicly raised funds shall not promote the funds to non-specific investors via newspapers, radio, television, Internet, and/or other public media, as well as in the form of lectures, seminars, analysis meetings, etc. It remains to be further clarified whether the aforementioned restrictions shall also apply to promotion via legitimate asset management products, such as trusts.

3) Provide a Mechanism for Fund Unit Holders that Assume Unlimited Joint and Several Liabilities

A non-publicly raised fund may stipulate that part of the fund unit holders can manage the investment activities of the fund as the fund manager, and assume unlimited joint and several liabilities when the fund assets can't repay its debts in the fund contract. With respect to such non-publicly raised fund, the fund contract shall also specify the names and domicile of the fund unit holders that assume unlimited joint and several liability, the conditions for expulsion and procedures for the replacement of fund unit holders that assume unlimited joint and several liability, as well as the conversion procedure between fund unit holders that assume unlimited joint and several liability and other fund unit holders.

4) Specify the Definition of Securities Investment Made with the Assets of Non-Publicly Raised Funds

According to the 2012 Securities Investment Funds Law, securities investments made with the assets of the non-publicly raised funds include dealing in stocks publicly issued by companies limited by shares, bonds, fund units, or other securities and their derivatives as prescribed by the SRA.

Compared to the Securities Investment Funds Law (Revised Draft), the 2012 Securities Investment Funds Law further specifies that "stocks" herein only refers to "stocks publicly issued by a company limited by shares", and doesn't include the equity of companies with limited liability. Thus, private equity investment funds that invest in the equity of companies with limited liability and non-publicly issued stocks of companies limited by shares are not likely to be subject to the regulatory supervisions under the 2012 Securities Investment Funds Law. However, as the SRA is authorized to define the "other securities and their derivatives" according to the 2012 Securities Investment Funds Law, we can't rule out the possibility that the SRA may expand its regulatory supervision by defining the scope of "other securities and their derivatives".

Strengthen the Protection of Investors

In addition to the above-mentioned investor protection mechanisms, the following measures are also significant in strengthening the protection of investors.

1) Further Specify a Manager Risk Reserves System

A manager risk reserves system is provided in the Notice on Issues Concerning Withdrawing Risk Reserves by Fund Management Companies, and the Decision of the China Securities Regulatory Commission on Revising the "Notice on Issues Concerning Withdrawal of Risk Reserves by Fund Management Companies," but not in Securities Investment Funds Law. Fund management companies shall withdraw risk reserves from fund management fee revenues each month at a rate of no less than 10% of such fund management fee revenues. No more risk reserves need to be

withdrawn when the risk reserve balance reaches 1% of the net fund assets. When the balance of the risk reserves is less than 1% of the net fund assets, withdrawal of the risk reserves shall be resumed until the said balance reaches 1% of the net fund assets.

While the 2012 Securities Investment Funds Law specifies that fund managers of publicly raised funds shall withdraw risk reserves from the remuneration from fund management. Where the fund manager is liable for compensating the losses suffered by fund assets or the damage caused to the legitimate rights and interests of the fund units holders due to its violation of laws or rules, breach of fund contracts or for other reason, the fund manager shall assume the liabilities for damage, it may compensate by using the risk reserves on a priority basis. Compared to the aforementioned regulations, the 2012 Securities Investment Funds Law has changed the withdraw base of risk reserves from "fund management fee" to "remuneration from fund management", which actually expands the base for risk reserves withdrawal, and enriches the risk reserves.

2) A System for Convening the Second-time General Meeting of Fund Unit Holders

According to the 2012 Securities Investment Funds Law, no general meeting of fund unit holders may be held unless holders representing at least 50% of the total fund units are present at the meeting. Where the fund units represented by the holders attending the general meeting of the fund unit holders fail to reach the required percentage, the convener may, after three months but within six months of the time when the said general meeting was originally announced to be held, convene a new general meeting of fund unit holders with respect to the matters that were scheduled to be deliberated at the original meeting. The newly convened general meeting of fund unit holders shall not be held unless holders representing at least one-third of the total fund units are present.

Miscellaneous

1) Specify the Tax Policy on Investments Made with Fund Assets

According to the 2012 Securities Investment Funds Law, taxes on investments made with fund assets shall be paid by the fund unit holders, and shall be withheld and collected by the fund managers or other withholding agents pursuant to the relevant tax collection regulations. Since non-publicly raised funds are not independent legal entities, non-publicly raised funds do not assume any tax liabilities.

2) Specify Restrictions on Investing in Securities by Related Personnel of Fund Managers

According to the 2012 Securities Investment Funds Law, the directors, supervisors, senior managers, and other practitioners of fund managers of publicly raised funds shall report to the fund manager in advance if they themselves, their spouses, or interested parties intend to invest in securities, and shall not cause conflicts of interest to arise with fund unit holders in such investments. The fund manager of publicly raised funds shall establish a management system for the reporting, registration, examination, and handling that relates to securities investments made by the persons

specified in the preceding provision, and shall report to the SRA for record-filing.

3) Specify Restrictions on Office Taking by Personnel of the SRA

According to the 2012 Securities Investment Funds Law and the Law of the People's Republic of China on Public Servants, personnel of the SRA shall not take office in fund companies within two years after leaving their posts, and the leaders of the SRA shall not take office in fund companies within three years after leaving their posts. The implementation of this measure shall avail the fund market to operate more fairly, and prevent certain market players from abusing its influence to cause unfair competition.

Overall, the 2012 Securities Investment Funds Law illustrates the idea of "relaxing the controls, strengthening the regulatory supervisions", and shall avail the unleashing of the dynamism of the fund industry, and further boost the development of the PRC fund industry. However, a large number of specific issues still remain to be clarified by detailed auxiliary rules and regulations.

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Legal Updates

1. Summary of Major Amendments to the PRC Labor Contract Law (Authors: Kelvin GAO, Alan WANG)

On December 28, 2012, the standing committee of the 11th National People's Congress has enacted *the Decision on Amendments to the PRC Labor Contract Law* (the "**Decision**") during its 30th Session, which will become effective on July 1, 2013.

The Decision mainly focuses on labor dispatch and here is a brief summary of the major amendments:

Use of Labor Dispatch

The Decision clearly provides that it is the basic form of employment for an employer that an employee should be hired by execution of a labor contract directly, while labor dispatch can just be a supplementary way for employment. Further, labor dispatch should only be applicable to temporary, auxiliary or substitute positions. Under the Decision, specific interpretation has been given to such terms (i.e., the term of "temporary position" should mean a job that will last not more than 6 months; the term of "auxiliary position" should refer to a job which provides services to positions of main business; and the term of "substitute position" should mean a job which is substituted by the dispatched workers since any employee can not work for certain period due to such reasons as full time study, taking leaves, and etc.).

Pursuant to the Decision, employers shall strictly control the number of dispatched workers used by them and the ratio of dispatched workers shall be kept under certain proportion of the total employment which will be determined by the labor administration department of the State Council later. Meanwhile, it is stated in the Decision that violation of the provisions related to labor dispatch will subject the relevant employer to the following penalties by the competent PRC labor governmental authority (i) the employer will be ordered to rectify the irregularities in a given time frame; and (ii) if the rectification has not been completed in a timely way, the employer will be imposed of a fine ranging from RMB5,000 to RMB10,000 for each dispatched workers involved.

Given the specific use of scope for labor dispatch, we understand that some adjustment may need to be made for an employer if its current way of employment is through labor dispatch (e.g., it has signed a dispatch agreement with a labor dispatch entity which will execute the labor contracts with relevant employees and then dispatch them to it) in accordance with the Decision, including, among others, termination of the underlying dispatch agreements and execution of labor contracts with the relevant employees directly.

In addition, if any employer would like to adopt the approach to terminate the dispatch agreements and sign labor contracts with its employees directly, the following may need to be considered by such employer in advance: (i) whether this approach will constitute the termination of labor contracts without causes which will lead to severance pay to be paid to relevant employees; (ii) whether this approach will affect the interests of employee (such as continuous calculation of working years); and (iii) whether any extra cost will be incurred if adopting such approach (e.g., expenses related to payment of social insurance and housing funds on its own). In this case, we would suggest that some human resource planning shall be better worked out in preparation for the Decision.

Please kindly note that so far the Decision has yet to give a clear interpretation for the term of "auxiliary position" which we understand will need to be further clarified in the future. Furthermore, the specific permitted amount of dispatched workers of an employer should also be regulated by the PRC labor administration department of the State Council.

Equal Pay for Equal Work

According to the Decision, dispatched workers of an employer should be entitled to the same pay as those of employees directly hired by such employer.

Since this has been clearly provided under the Decision, an employer should pay attention to this when using dispatched workers.

Licenses for Labor Dispatch

The Decision raises the minimum capital threshold for establishment of a labor dispatch entity from RMB500,000 to RMB2,000,000. Further, it is provided under the Decision that no entity or individual can be engaged in labor dispatch business without the labor dispatch license issued by the competent PRC labor governmental authority. In addition, the Decision intensifies the penalties against labor dispatch entities (i.e., failure of any entity engaged in labor dispatch business to obtain the permits will be ordered to stop business operation, be confiscated the illegal gains and be imposed of a fine ranging from one time to five times of the illegal gains or a fine of up to RMB50,000 if there is no illegal gains).

Given the above, an employer will need to examine and verify the relevant licenses before engaging any labor dispatch entity. In addition, a labor dispatch entity may not start its business operation until it obtains the license.

Additionally, the Decision further provides the transitional arrangement. According to the Decision, it will not affect the labor contracts and dispatch agreements already signed on or prior to its promulgation until expiration of their terms. But the relevant provisions in the labor contracts and dispatch agreements will need to be revised in the event of existence of any provision violating the

principle of "equal pay for equal work" therein. Further, an entity engaging in labor dispatch business on or prior to the effective date of the Decision should be generally allowed to obtain the labor dispatch license within one (1) year upon the effectiveness of the Decision and after that, it can continue to conduct labor dispatch business.

Hope the above has been a helpful summary to you. If you have any questions, please don't hesitate to contact us at any time.

2. CSRC Cancels the "456 Conditions" to Encourage Domestic Enterprises' Overseas Offerings and Listings (Author: Yang CHEN)

On December 20, 2012, the China Securities Regulatory Commission (the "**CSRC**") released the *Regulatory Guidance on Application Documents of and Review Procedures for Overseas Offering and Listing of Joint-Stock Companies* (the "**Guidance**"), which clarifies the conditions, application documents, and review procedures for domestic enterprises' overseas offerings and listings. The Guidance will take effect on January 1, 2013. The *Notice on Issues concerning Application for Overseas Listing by Enterprises* (Zheng Jian Fa Xing Zi [1999] No. 83, the "**Notice**") issued by the CSRC on July 14, 1999 will be repealed simultaneously.

The Guidance 1) relaxes the limitation for domestic enterprises' overseas offerings and listings, 2) no longer sets conditions on enterprise finance for enterprises' overseas listings, 3) cancels the original pre-procedure that requires the enterprise to solicit the opinion of the Public Offering Supervision Department of the CSRC on the overseas listing application, and 4) simplifies the review procedures and application documents. The Guidance therefore makes it more adjustable to meeting the financing needs of domestic enterprises particularly small and medium-sized enterprises ("SMEs") in overseas offerings and listings as well as in H-share offerings and listings. This Guidance is also helpful in reducing the stress formed by too many projects waiting to get approved by the CSRC on the A-share market. The details of the Guidance are as follows:

Relaxing the Limitations for Domestic Enterprises' Overseas Listings, Canceling the Requirements on Finance, Purposes of Funds Raised, and Foreign Exchange Sources of Dividends for Enterprises' Overseas Listings

The Guidance provides that joint-stock companies established according to the *Company Law of the People's Republic of China* ("**Company Law**") can independently file overseas offering and listing applications with the CSRC if they meet the relevant local listing conditions. In addition, the Guidance no longer sets conditions on net assets, net profits, and raised amounts, and only requires legally established domestic enterprises proposing overseas listing to comply with the relevant local listing requirements.

Before its repeal by the Guidance, the Notice required domestic joint-stock companies applying for listing on overseas main board markets to meet a series of conditions, which includes the following:

1) Requirements of raised purpose: the purpose of funds raised shall conform to the provisions of the national industrial policies, foreign investment utilization policies, and the relevant regulations on the initiation of fixed asset investments;

2) Financial requirements of net asset, net profit, and raised amount: the net assets shall be not less than RMB 400 million, the after-tax profits in the previous year shall be not less than RMB 60 million, and the amount raised from the domestic enterprise's offering and listing shall have the potential for growth. The raised amount shall be not less than USD 50 million based on a reasonable forward price-to-earnings ratio (these requirements are collectively referred to as the "**456 Conditions**");

3) Requirements of corporate governance: enterprises shall have a standard corporate governance structure, an integrated internal management system, a stable senior management, and a high-level management; and

4) Requirements of foreign exchange sources of dividends: dividends after listing shall have reliable sources of foreign exchange and comply with the relevant state regulations on foreign exchange administration.

The conditions on purpose of funds raised and foreign exchange sources, as well as the 456 Conditions in the Notice have all played a positive role in promoting large enterprise overseas listings. However, the conditions at the same time hinder some exceptional small and medium-sized enterprises from listing overseas. Although the local overseas listing requirements are mostly lower than that of the CSRC, before the Guidance was issued, small and medium-sized private enterprises that failed to meet the above-mentioned conditions were only able to do overseas listing indirectly by transforming the company into a Red Chip[2]. After the Guidance is put into effect, domestic enterprises can file overseas listing applications if they meet the relevant local listing conditions, which will further widen the means for small and medium-sized enterprises' overseas listings.

Canceling the Original Pre-procedure that Requires Enterprises to Solicit the Opinion of the Public Offering Supervision Department of the CSRC on Overseas Listing Applications

Before the Guidance is put into effect, according to the Notice, three months prior to filing a preliminary application with an overseas securities regulatory authority or stock exchange[3], an

[2] Red Chip here refers to when a domestic Chinese enterprise transfers its domestic assets to the offshore enterprises through methods such as a stock-swap in order to make itself adhere to the requirements of the overseas offering and listing.

[3] An example of this would be submitting a Form A1 to the Hong Kong Stock Exchange when applying for an H-share offering.

enterprise shall submit the relevant documents to the CSRC, and shall solicit the opinion of the Public Offering Supervision Department of the CSRC on the overseas listing application. Only after obtaining a written notice of approval for the application issued by the CSRC, can an enterprise file a preliminary application with an overseas securities regulatory authority or stock exchange.

The Guidance revokes the original pre-procedure that requires enterprises to solicit the opinion of the Public Offering Supervision Department of the CSRC on the overseas listing application. After the Guidance has been put into effect, domestic enterprises will be able to independently file overseas listing applications with the CSRC if they meet the local overseas listing requirements. The CSRC will conduct a formal examination to decide whether or not to accept the application. Where the application falls within the CSRC's scope of authority and the application documents are complete as well as conform to the statutory format, the acceptance department shall issue a notice of acceptance according to the *Provisions of the China Securities Regulatory Commission on the Implementation Procedures for Administrative Permit*. The CSRC will not conduct substantive reviews when deciding whether or not to accept the application documents of domestic enterprises' overseas offering and listing. After receiving the CSRC's notice of acceptance, domestic enterprises can file a preliminary application with an overseas securities regulatory authority or stock exchange.

The CSRC Can Choose Whether to Consult with the National Development and Reform Commission

The Guidance states that after receiving the application documents, the CSRC can consult with the appropriate departments about the national industrial policies, foreign investment utilization policies, and the relevant regulations on fixed asset investment administration.

The Notice provides that the CSRC shall consult with the State Planning Commission and the State Economic and Trade Commission (that is the predecessor of the National Development and Reform Commission of the People's Republic of China, hereinafter referred to as the "**NDRC**") about whether the relevant applications conform to the provisions of the national industrial policies, foreign investment utilization policies, and the relevant regulations on the initiation of fixed asset investments. According to the Notice, it is necessary for the CSRC to consult with the NDRC about the initiation of fixed asset investments and related issues when reviewing the application for domestic enterprises' overseas listings.

The Guidance provides that the International Department of the CSRC can independently decide whether or not to consult with the relevant departments including the NDRC. It is no longer necessary to consult with the NDRC. For small and medium-sized enterprises with no relation to fixed asset investment projects, the CSRC may not consult with the NDRC.

Simplifying the Application Documents Submitted to the CSRC

The Guidance streamlines the application documents submitted to the CSRC. Compared to the provisions of the Notice, the Guidance stipulates that domestic enterprises applying for overseas offering and listing need not submit the following documents to the CSRC:

1) The application report need not include a restructuring plan and profit forecast of the current year as well as the basis of the forecast;

2) The approval document for the enterprise's overseas listing issued by the Provincial People's Government in the place where the enterprise is located or in the relevant departments under the State Council;

3) The analysis and recommendation report on the enterprise's listing from an overseas investment bank;

4) The written reply of an approval authority on the establishment of a joint-stock company and the conversion into an overseas fundraising company;

5) The confirmation document of asset evaluation and the written reply on state-owned equity management issued by the state-owned assets administration department;

6) The confirmation document of land use rights evaluation and the written reply on the plan for land use rights disposal issued by the land and resource administration department;

7) The restructuring agreement, the service agreement, and other relevant agreements on tariff trade;

8) The asset evaluation and profit forecast reports.

The Guidance requires that domestic enterprises applying for overseas offering and listing submit the following additional documents:

1) The application report shall include corporate governance structure, operational risk analysis, and development strategy;

2) The relevant board resolution;

3) The Business License of the company, the business approval certificates for special approval business (if applicable);

4) The regulation opinion letter issued by the business supervision authorities (if applicable);

5) The relevant written reply on state-owned equity set and state-owned equity reduction/transfer issued by the state-owned assets administration department (if applicable);

6) The examination, approval, and registration documents of the raising of funds investment project (if applicable);

7) The tax certificate documents; and

8) The environmental certificate documents.

Retaining the Approval Procedure of CSRC

The Guidance provides that domestic enterprises can file a preliminary application with an overseas securities regulatory authority or stock exchange after obtaining the CSRC's notice of acceptance. Such domestic enterprises can also file a formal application with an overseas securities regulatory authority or stock exchange after obtaining the CSRC's administrative approval document.

The Guidance retains the provision of the Notice that before filing a formal application with an overseas securities regulatory authority or stock exchange, domestic enterprises shall obtain the CSRC's administrative permit document. In addition, the domestic enterprise's overseas offering and listing shall still be subject to CSRC examination, approval, and supervision.

A Written Report Shall Be Submitted to the CSRC When Listing and Transfer Listing

The Guidance provides that enterprises shall submit a written report on the overseas offering and listing to the CSRC within 15 workdays after its completion. In addition, enterprises that transfer list on different boards in the same country shall submit a written report on its transfer listing to the CSRC within 15 workdays after its completion. Enterprises in any circumstances mentioned hereinbefore only need to submit to the CSRC for filing and the CSRC will not conduct a substantive examination.

3. Shenzhen Launches its QFLP Pilot Program (Authors: James WANG, Yuan LIN)

The Shenzhen Special Economic Zone has always been one of the most important Chinese cities for private equity funds. On June 27, 2012, the State Council promulgated the *Reply of the State Council on Policies Supporting the Development and Opening-up of the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone* (《国务院关于支持深圳前海深港现代服务业合作区开发开放有关政策的批复》)(Guo Han [2012] No.58) (the "**State Council Reply**"). The State Council Reply supports the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone's ("**Qianhai**") pioneering policies on financial reform and innovation, which makes Qianhai into a so-called "special zone of the special zone" and brings new opportunities for the further development and innovation of private equity funds in Shenzhen.

In the first step of implementing the State Council Reply, Shenzhen pushed for the development of foreign-funded equity investment by promulgating *The Interim Measures for the Launching of a Pilot Program for Foreign-funded Equity Investment Enterprises in Shenzhen*(《关于本市开展外商投资股权投资企业试点工作的暂行办法》) (Shen Fu Jin Fa [2012] No.12) (the "**Interim Measures**") on November 26, 2012. Jointly formulated by the Shenzhen Financial Services Office, Shenzhen

Economy, Trade, and Information Commission, Shenzhen Market Supervision Administration, and Qianhai Administration Bureau, the Interim Measures indicate that the QFLP program of Shenzhen has now officially begun.

The Shenzhen QFLP program has many similarities with the Shanghai QFLP program with regard to the threshold for the limited partners of pilot foreign-funded equity investments, while being silent on the quota of the settlement of foreign exchange for investment purposes. It is said that the current Shenzhen government has reported and applied to the State Administration of Foreign Exchange for the QFLP quota. Formulating policies that enhance the QFLP's actual used quota of foreign exchange settlements and stimulate QFLP capital to invest in the local real economy is one of the most difficult problems that pilot QFLP local governments are currently working to resolve. As far as we know, unlike providing a separate foreign exchange settlement quota to each of the pilot PE funds in Shanghai, Shenzhen may be expected to create new innovative ways for the approval of foreign exchange settlements by virtue of Qianhai's policy advances of Qianhai. An example of this might include Shenzhen requiring pilot PE funds to submit materials of investment projects first, and then determining the actual foreign exchange settlement quota for the single project in accordance with the soon-to-be promulgated supportive policy for new strategic industries, so as to solve the aforesaid difficult problem. However, considering the policy demands of controlling "hot money," it is still uncertain whether such a form of approval for foreign exchange settlements can be passed and implemented.

Moreover, there is no "national treatment clause"[4] like the Shanghai QFLP in the Interim Measures. It has been reported that Shenzhen hopes to appropriately extend the project investment limitations of the pilot foreign PE funds registered in Qianhai, and increase such funds' share proportions within the framework of the *Catalogue of Industries for Guiding Foreign Investment*. However, under the broader policy background that the National Development and Reform Committee(the "**NDRC**") issued in *The Reply Letter of the General Office of NDRC on Relevant Issues Relating to Foreign-invested Equity Investment Enterprises* on April, 2012, the NDRC affirms that RMB funds in the form of a limited liability partnership with a foreign-invested company as general partner ("GP") and with only PRC domestic investors as limited partners ("LPs") shall still be deemed as foreign investors, and their portfolio investments are therefore subject to the *Catalogue of Industries for Guiding Foreign Investment*. However, such breakthrough still has a considerable amount of uncertainty.

[4] Shanghai Financial Services Office, Shanghai Municipal Commission of Commerce and Shanghai Administration for Industry & Commerce jointly promulgated *The Implementation Measures for the Launching of a Pilot Program for Foreign-funded Equity Investment Enterprises in Shanghai* on December 24, 2010, Article 24 of which provides that the foreign-funded equity investment management enterprises that have been approved to participate in the pilot program may use foreign exchange funds as capital contribution to the equity investment enterprises sponsored and established by such enterprises, provided that the amount shall not exceed 5% of total funds raised. The said portion of capital contribution shall not affect the original type of the invested equity investment enterprise.

We will keep a close eye on any breakthroughs and innovations in the Shenzhen QFLP program that are supportive of the pioneering policies in Qianhai.

Below are the key points of the Interim Measures:

1) Competent Authority

A pilot program leading group (the "**Leading Group**") of foreign-funded equity investment enterprises consisting of the Shenzhen Financial Services Office, Shenzhen Economy, Trade, and Information Commission, Shenzhen Market Supervision Administration, Qianhai Administration Bureau, Shenzhen Development and Reform Commission, and the People's Bank of China Shenzhen Central Sub-branch is responsible for the following duties: accepting applications, examination and approval, record-filing and managing foreign-funded equity investment enterprises and foreign-funded equity investment management enterprises(collectively, the "**Pilot Enterprises**"), as well as accepting the applications and examination of pilot custodian banks, and formulating and implementing the relevant supportive policies.

2) Application Scope

According to the Interim Measures, the pilot program will be the first implemented in Qianhai to increase financial cooperation between Shenzhen and Hong Kong and promote the innovative development of equity investment fund industries in Qianhai, and gradually be implemented in all of Shenzhen's districts in the future. However, the Interim Measures do not state the specific time of implementation in all districts of Shenzhen.

3) Registered Capital

(1) For a foreign-funded equity investment enterprise: the subscribed capital contribution shall not be less than USD15 million or the equivalent with capital contributions to be made in cash only; except for general partners, the capital contributions of each of the other limited partners shall not be less than USD1 million or the equivalent.

(2) For a foreign-funded equity investment management enterprise: the registered capital (or subscribed capital contribution) shall not be less than USD 2 million or the equivalent, with capital contributions to be made in cash only.

(3) Time of Contribution: at least 20% of the registered capital (or subscribed capital contribution) shall be in place within three months of the issuance date of the business license, with the balance to be paid up within two years.

4) Senior Management Personnel

A foreign-funded equity investment management enterprise shall have at least two senior management personnel who shall both meet with the requirements provided in Article 7 of the Interim Measures, which are listed in the following points:

- five or more years practical experience in equity investment or equity investment management activities;
- two or more years experiences in senior management duties;
- experience in the practice of China-related equity investment or practical experience in a financial institution in China;
- have no record of violating Chineselaws or regulations, nor pending economic dispute lawsuits in the most recent five years; and
- havea positive personal credit record and etc.

5) Foreign Investor Requirements

Foreign investors of Pilot Enterprises applying to be under the pilot program shall possess sound governance structures and comprehensive internal control systems without having penalties imposed by judicial authorities and relevant supervisory authorities in the most recent two years. Foreign investors or affiliated entities thereof shall have relevant investment experience, and the investors shall be primarily formed by foreign sovereign wealth funds, retirement funds, endowment funds, charity funds, fund of funds (FOF), insurance companies, banks, securities companies, as well as any other foreign institutional investors approved by the Leading Group.

6) Name

Pilot Enterprises examined and approved by the Leading Group may indicate in their names through the wordings "equity investment fund" or "equity investment fund management".

7) Fund Sources

The contributions of foreign investors in cash shall be in the form of: (i) freely convertible currency, (ii) overseas RMB, (iii) the RMB profits obtained within the territory of Mainland China thereof, or (iv) legal gains in RMB obtained as a result of activities such as share swaps or liquidation. Capital contributions by Chinese investors shall be made in RMB.

8) Fund Custodian

Pilot Enterprises shall authorize a bank registered in Shenzhen that satisfies the requirements to be the fund custodian. The custodian bank shall bear the responsibility of submitting regular reports

to the Leading Group on information such as the operating conditions of entrusted funds, and investment projects, as well as the domestic equity investment conditions of Pilot Enterprises.

9) Establishment, Change, and Record-filing

(1) Establishment: a Pilot Enterprise applying to be under the trial program shall submit a pilot application to the Shenzhen Financial Services Office through the executive partner of the equity investment enterprise intended to be established. After the preliminary examination, the Shenzhen Financial Services Office will submit the application to the Leading Group for examination and approval.

(2) Change: the Shenzhen Market Supervision Administration shall seek the opinion of the Shenzhen Financial Services Office when a Pilot Enterprise changes its business scope, partners, the amount of subscripted or paid-up capital contribution, payment deadline of the subscription or payment, or type of the partnership enterprise.

Record-filing: a Pilot Enterprise shall submit a report to the Shenzhen Financial Services Office every six months regarding major events that have occurred in the course of its investment operation during the previous half of the year, such as: investments made by the Pilot Enterprise, changes in senior management personnel, the management enterprise, and the registered capital (subscribed capital contribution), divisions or mergers, dissolution, liquidation or bankruptcy, etc.

4. SAFE's New Amendment to QFII Forex Rules (Authors: James WANG, Yuan LIN, Lu RAN)

SAFE promulgated an amendment to the *Provisions on the Foreign Exchange Administration of Domestic Securities Investment by Qualified Foreign Institutional Investors* (Announcement of the State Administration of Foreign Exchange [2012] No. 2, the "**Amendment**") on December 7, 2012. The changes made to the old QFII Forex Rules promulgated on September 29, 2009 (the "**Old Rules**") are listed as follows:

1) The upper limit on the amount of investments made by foreign sovereign wealth funds, institutions of the central bank, and monetary authorities are allowed to exceed USD 1 billion or the equivalent.

2) The open-end China funds ("OECFs") may managethe relevant inward or outward remittance on a weekly basis (rather than a monthly basis as provided in the Old Rules) according to the net amount of netting for subscriptions and redemptions.

3) The total amount of capital (both principal and interest) repatriated by a qualified foreign

institutional investor ("QFII") or an OECF in any month is now limited to 20% of its total asset value within China at the end of the previous year.

4) Within the above-mentioned 20% limit, the custodian bank may handle the capital repatriation of OECFs directly without obtaining SAFE approval.

5) Simplify the procedure of profits repatriation. For QFIIs other than OCEFs, the custodian bank may handle the repatriation of profits directly based on an audited report and confirmation of tax payment without obtaining SAFE approval. However, the repatriation of principal still requires advance approval by SAFE.

6) The Custodian shall submit the Monthly Forms I and II for Domestic Securities Investment by QFIIs within five (5) working days after the end of each month, which is shorter than the Old Rules of eight (8) working days.

7) The QFII shall open the RMB Dedicated Deposit Account ("**DD Account**") corresponding to its foreign exchange accounts in the custodian bank or other domestic commercial bank according to the *Operation Guidelines for the Domestic Account of Qualified Overseas Institutional Investors* ("**Operational Guidelines**"), which provides the following:

- The DD Account shall be divided into a DD Account (Securities Trading) that shall be opened in the domestic custodian bank and a DD Account (Futures Trading) that shall be opened in the bank where the futures margin is deposited.
- The scope of the income and expenditure of the QFIIs' special RMB accounts shall be consistent with the DD Accounts (Securities Trading).
- QFIIs may not apply for more than six (6) DD Accounts (Securities Trading) for the clients they manage.The initial deposit amount of each account shall not be lower than USD 20 million or the equivalent.
- If a QFII needs to open several DD Accounts for the purpose of conducting sectional ledger management to the special RMB account that has been opened for the client's funds, it shall apply to SAFE within six (6) months from the promulgation date of the Operational Guidelines (e.g., December 7, 2012). The QFII shall transfer such capital to the new opening DD Account all at once after obtaining the SAFE's approval, and the custodian bank shall file the relevant information for record within ten (10) working days after such transfer with SAFE.

Important Announcement

This Newsletter 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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