Shanghai
19F, ONE LUJIAZUI
68 Yin Cheng Road Middle
Shanghai 200120 P.R.China
Tel: (86 21) 3135 8666
Fax:(86 21) 3135 8600

Beijing
Units 902-903
Winland International Finance Centre
No.7 Finance Street, Xicheng District
Beijing 100033 P.R.China
Tel: (86 10) 6655 5050
Fax:(86 10) 6655 5060

上海
上海市银城中路68号
时代金融中心19楼
邮政编码: 200120
电话: (86 21) 3135 8666
传真: (86 21) 3135 8600
www.llinkslaw.com

北京
北京市西城区金融大街7号
英蓝国际金融中心9楼02-03单元
邮政编码: 100033
电话: (86 10) 6655 5050
传真: (86 10) 6655 5060
master@llinkslaw.com

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NDRC Issues the First Nationwide Administrative Rules on Equity Investment Enterprises

By David Yu, Nicholas Lou and Teddy Li

Following the issuance of the Notice on Further Regulating the Development and Filing Administration of Equity Investment Enterprises in Pilot Areas (Fa Gai Ban Cai Jin [2011] No. 253, the "**Notice No. 253**") by the General Office of the National Development and Reform Commission (the "**NDRC**") on 31 January 2011, the NDRC further issued the Notice on Promoting the Standardized Development of Equity Investment Enterprises (Fa Gai Ban Cai Jin [2011] No. 2864, the "**Notice**") on 23 November 2011, as a nationwide-applicable normative document which further regulates the establishment, capital raising and filling administration of equity investment enterprises. This article analyzes several key points of the Notice.

Capital Source Restriction

The Notice imposes restriction on the sources of subscribed capital for contribution for the first time in a document on the central government level.[1] The Notice stipulates that all investors of equity investment enterprises may only make capital contribution with legitimate self-owned monetary funds, yet, it does not give further definition of the meaning and scope of "self-owned funds".

Nevertheless, as issues regarding the grouping of investors in the form of collective capital trusts and the calculation of the their number are mentioned in the Notice, it seems that funds raised by means of collective capital trust is not excluded from self-owned funds, from the perspective of integrated interpretation of the Notice.

Limitation on the Number of Investors

The Notice specifies that the number of investors of equity investment enterprises shall be subject to relevant provisions in the Company Law

如果您需要本出版物的中文本，请与下列人员联系：

郭建良: (86 21) 3135 8756
Publication@llinkslaw.com

If you would like other Llinks publications, please contact:

Roy Guo: (86 21) 3135 8756
Publication@llinkslaw.com

Llinks Law Offices
www.llinkslaw.com

and the Partnership Enterprise Law. However, with regard to the calculation of the number of investors, the Notice further states that in the event the investor is an unincorporated entity such as collective capital trust or partnership enterprise, a thorough review of whether each of such investor's controlling entities of every level up to the top is a qualified investor, regardless of individual or legal entity, is required. The total number of investors shall then include all such controlling entities. However, all fund-of-funds (the "FOF"s) are exempted by the Notice from such review and will not be added to the total number of investors.

In accordance with the official explanation given by the NDCR, the purpose of the Notice is to prevent illegal fund-raising. However, the stipulation regarding the calculation of the number of investors under the Notice does not seem to have any sufficient legal basis under the Company Law or the Partnership Enterprise Law, yet boosts similarity to the requirement for accumulative calculation of investors upon public offering under the Securities Law.[2] Thus, in practice, how to consolidate the number of investors for calculation still depends on the understanding of related authorities.

Besides, as an exception in the calculation of the total number of investors, the FOF is not clearly defined in the Notice. It is possible that NDRC will, subject to its confirmation, require FOFs to undergo filings for equity investment enterprises or venture capital investment enterprises. From practice perspective, due to the restriction on the total number of investors, there is no doubt that the calculation method presented by the Notice will to a great extent, impact many existing equity investment enterprises that raise funds through complicated structures such as collective fund trust or partnership enterprises.

Mandatory Filing Requirement

Before the promulgation of the Notice, equity investment enterprises with capitals of less than RMB500,000,000 were exempted from filing with NDRC by the Notice No.253, and their other filing requirements were subject to rules made by the local government and competent departments where they were registered. For example, the *Measures for Administration of Tianjin Equity Investment Enterprises and Equity Investment Management Institutions* (Jin Fa Gai Cai Jin [2011] No.675) requires the minimum amount of registered (subscribed) capital of an equity investment enterprise to be no less than RMB100,000,000, and that equity investment enterprises with capital of more than RMB100,000,000 but less than RMB500,000,000 shall apply to the Tianjin Equity Investment Fund Developing and Filing Management Office ("**Tianjin Filing Office**") for filing. Local authorities in Shanghai promulgated the *Notice on Business Registration of Equity Investment Enterprises in Shanghai (revised)* (Hu Jin Rong Ban Tong [2011] No. 10) and the *Notice on the Implementation of Filing Management of Equity Investment Enterprises in Shanghai by the Shanghai Development and Reform Commission and the Shanghai Financial Services Office* (Hu Fa Gai Cai Jin [2011] No. 045)[3] in 2011, which also provides that the minimum amount of the capital of an equity investment enterprise shall be no less than RMB100,000,000. Yet no mandatory filing requirement or related detailed rules were issued in Shanghai governing equity investment enterprises with capital of less than RMB500,000,000.

However, the Notice now requires all equity investment enterprises, regardless their capital sizes, to undergo the filing procedure within one month after registration with the administration of industry and commerce. Only (i) venture capital investment enterprises which have completed the filing in accordance with Interim Measures on the Administration of Venture Capital Firms, (ii) enterprises established by single organizations or single individuals, and (iii) enterprises established by a single institution and its sole subsidiary or by multiple subsidiaries of such institution are exempted from the abovementioned requirement. It is also stipulated by the Notice that equity investment enterprises whose capitals amount to RMB500,000,000 or more shall apply to the NDRC for filing, and those whose capital are less than RMB500,000,000 shall apply for filing to the competent department designated by the provincial government.

In conclusion, the Notice requires every equity investment enterprise to apply for filing, while those with the capital of less than RMB500,000,000 may just file with their local authorities. Therefore, it is expected that with the promulgation of the Notice, local governments and the designated filing administration departments will soon issue detailed filing rules. Otherwise, the filing administration of equity investment enterprises with the capital of less than RMB500,000,000 will then be left unsupervised.

Supervision and Rectification Requirements

The Notice also specifies that any equity investment enterprise or equity investment management institution who (i) fails to satisfy the filing requirement within the specified time after receiving the notice of filing from competent departments, or (ii) fails to operate in accordance with the requirements under the Notice, will be deemed as an equity investment enterprise or equity investment management institution that "intentionally evades the filing supervision", or "is managed and operated irregularly", and will be disclosed to the public on websites of the filing administration departments. However, whether or not such penalty constitutes an administrative penalty and what its legal basis is needs further discussion.

In addition, the Notice provides that any equity investment enterprise or equity investment management institution established before the implementation of the Notice whose investments and operation do not conform to the rules therein, shall rectify all irregular behaviors in accordance with related rules within six months after the promulgation of the Notice. However, the Notice does not provide any specific method of such rectification or its details. In view of policy stability, if relevant competent departments may further detail the rectification requirements, equity investment enterprises that established before the Notice will then be able to steadily carry out the rectification in a more orderly manner.

From the above analysis of the Notice's key points, it seems that the NDRC is gradually tightening its administration over equity investment enterprises. Yet, the coordination between the NDRC and other administrative authorities, particularly the local governments in the supervision of equity investment enterprises requires further concern. Moreover, from practicability perspective, the requirements in the Notice regarding the capital source restriction, the number of investors, the filing requirements and rectification methods of equity investment enterprises need further clarification.

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Contact Details

If you would like to know more information about the subjects covered in this publication, please feel free to contact the following people or your usual Llinks contact.

Shanghai	Beijing
David Yu Tel: (86 21) 3135 8686 David.Yu@llinkslaw.com	**James Weng** Tel: (86 10) 6655 5050 – 1028 James.Weng@llinkslaw.com
Ming Zhang Tel: (86 21) 3135 8777 Ming.Zhang@llinkslaw.com	
Clare Lu Tel: (86 21) 3135 8667 Clare.Lu@llinkslaw.com	

1 Before the issuance of the Notice, *Measures for Administration of Tianjin Equity Investment Enterprises and Equity Investment Management Institutions* (Jin Fa Gai Cai Jin [2011] No.675) has set forth specific requirements on "self-owned funds". It specifies that the investors of the equity investment enterprises and the management institutions shall contribute the capital with self-owned monetary funds, and equity investment enterprises and the management institutions are prohibited to allow numerous investors to jointly entrust a particular investor to subscribe to the capital.

2 Article 10 of Securities Law of the People's Republic of China states that it shall be deemed as a public issuance upon the occurrence of any of the following circumstances: (2) making a public issuance of securities to accumulatively more than 200 specified objects.

3 i.e. *Notice on Business Registration of Equity Investment Enterprises in Shanghai and Notice on the Implementation of Filing Management of Equity Investment Enterprises in Shanghai*.