

NDRC Enhances Administration over Equity Investment Enterprises

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On 18 March 2013, the general office of National Development and Reform Commission (“NDRC”) issued a *Circular on Enhancing the Administration and Filing of Equity Investment Enterprises (Fa Gai Ban Cai Jin [2013] No.694)* (“**Circular 694**”). Circular 694 marks as NDRC’s further notice on the administration and filing of equity investment enterprises nationwide, on top of 2011’s “**Circular 2864**” (*Circular on Promoting the Compliant Development of Equity Investment Enterprises by the General Office of National Development and Reform Commission, Fa Gai Ban Cai Jin [2011] No. 2864*) and 2012’s “**Filing Guide**” (*General Office of National Development and Reform Commission’s Notice on Publishing the Meeting Memorandum Regarding Equity Investment Enterprises Nationwide and the Filing Documentation/Standard Format Guide for Equity Investment Enterprises, Fa Gai Ban Cai Jin [2012] No. 1595*).

Since its birth, Circular 694 has been at the center of discussion in the market. Other than the filing of equity investment enterprises (“EIE”)s which draws considerable attention, the legality of the participation of EIEs and equity investment management enterprises (“EIME”)s in raising and/or managing public and/or private securities investment fund has been most heatedly discussed. This article explores Circular 694 by briefly elaborating the entities and acts regulated by it. Particular explanations are also made here to set subjects regulated by Circular 694 apart from those governed by China Securities Regulatory Commission (“CSRC”) to avoid misinterpretation in practice.

Background of Circular 694

Circular 694 is issued under two circumstances as follows:

- Since the issuance of Circular 2864 in late 2011, NDRC has started to implement nationwide administration over EIEs by requiring mandatory filing at NDRC level. In particular, EIEs of RMB500 million and over are required to file. Following Circular 2864,

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several municipalities such as Beijing, Tianjin, and Shanghai have issued or updated their local detail rules to administer EIEs. However, as shown in a meeting memorandum of EIE administration meeting attached to the Filing Guide, the local filing of EIEs of less than RMB500 million have not been fully implemented. As a result, a number of EIEs which should have filed with local governmental authorities have failed to do so. Therefore, Circular 694 devoted considerable efforts to require local governmental authorities to speed up the circulation of EIE filing mechanism and aim to issue related rules soon.

- Prior to Circular 694, the *Securities Investment Funds Law* has just seen its revision in 2012 and is scheduled to enter into effect on 1 June 2013. According to the revision, entities other than fund management companies, if duly approved by CSRC, may serve as manager of public securities investment funds. CSRC then issued an *Interim Regulation on the Participation of Asset Management Entities in Public Securities Investment Funds* (“**Interim Regulation**”) on 18 February 2013, expressly confirming that EIMES, venture capital management entities and other asset management entities in compliance with such regulation may engage in the raising and managing of public securities investment funds¹. As a result, many EIMES are currently preparing to apply and initiate their participation in public securities investment funds.

As such, the market has been overwhelmed by discussions of Circular 694 since it was issued. The discussions primarily revolve around the fact that Circular 694 deems it irregular for EIEs and EIMES to raise or manage public and/or private securities investment funds. Some media and professionals see Circular 694 as putting a “ban” on EIEs and EIMES in their participation in raising and managing public or private securities investment funds, while others put it more directly as the conflict of the administrative power between two governmental departments (i.e. CRSC and NDRC)².

Further Enhancing Filing Requirement on EIEs

One primary goal of Circular 694 is to further enhance the filing and administration of EIEs. This is achieved by the following:

- Require Local Authorities to Speed Up Issuance of Filing Rules

As stated in Section I above, local authorities are undertaking the filing of EIEs of less than RMB500 million, yet most local authorities do not have rules to guide the filing. Therefore in practice, EIEs of less than RMB500 million are not able to undergo filing, nor are they being required to do so. In this regard, Circular 694 puts it in the first provision that local authorities shall speed up the circulation of EIE filing mechanism, and shall issue detailed rules before the end of June 2013 either in the form of local governmental regulation or government departmental regulation.

- Require Local Authorities to Be Informed of Current Market Situation, and Implement the “File If Should” Policy

Circular 694 requires local authorities to execute the “File if Should” policy on EIEs, that is, to urge all EIEs that primarily engage in equity investment to promptly complete local filing in accordance with relevant rules. Also, local authorities are required to actively undergo risk check on the entire equity investment industry, and submit relevant reports and industry summary before the end of April, 2013.

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In accordance with Circular 694, local authorities may implement the following measures on EIEs that are required to file:

- Contact the relevant EIE and require it to undergo filing procedures within a specified time period;
- Require EIEs that do not conform to Circular 2864 and local filing rules to rectify the non-compliance with a specific time period, and request such EIEs to re-submit all filing application documents thereafter. Any EIE that fails to do so will be listed on NDRC's website both nationally and provincially as an "irregularly operated equity investment enterprise";
- List any EIE that (i) do not conform with Circular 2864 and Filing Guide, who carries out irregular investments, and (ii) fails to rectify the non-compliance within a specified time period on NDRC's website both nationally and provincially as an "irregularly operated and managed equity investment enterprise or equity investment management enterprises";
- Publicly list any EIE that fails to undergo filing after multiple notifications as an "administration-evading equity investment enterprise".

It is noteworthy that Circular 694 makes it clear that EIEs incorporated before the issuance of Circular 2864 will also be subject to filing and administration, thus making Circular 2864 retroactive.

In accordance with the above NDRC rules, applicable EIEs should diligently prepare filing paperwork once required or notified by corresponding local filing authorities, in order to avoid being publicly listed as "administration-evading equity investment enterprise" for their negligence or non-cooperative behavior in filing.

Understanding of NDRC's "Denial" of EIEs in Public Securities Investment Fund Business

What makes Circular 694 controversial is its provision regarding the legality of EIEs and EIMEs' business, which is quoted as follows:

"Any act of raising or managing any public or private securities investment funds, financial derivatives investment funds, or funds that provide loans by any equity investment enterprise or equity investment management enterprise shall be irregular, and shall be rectified within a required time limit. In the event that such failure is not timely rectified, the corresponding enterprise shall be publicly listed as "irregularly operated and managed equity investment enterprise equity investment management enterprises" on the website of State's or provincial filing authority."

With regard to the above rule, Circular 2864 originally provides that "equity investment enterprises shall invest in non-publicly traded equities, and any extra money of theirs shall only be deposited in banks or used to purchase fixed-return investment products such as State bonds". However, Circular 694 goes further now to classify "any act of raising or managing any public or private securities investment funds, financial derivatives investment funds, or funds that provide loans" as irregular.

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Taking a look at the Circular 694 and CSRC's Interim Regulation (Section 16.2³), literally the two would seem contradictory regarding the legality of EIE's participation in raising/managing public/private securities investment funds, as NDRC and CSRC seem to have answered differently. However, a closer inspection would tell that CSRC's Interim Regulation has not expressly entitled equity investment management entities to carry out securities asset management.

From administration perspective, NDRC's rules aim to regulate the business of "investment and management of non-publicly traded equities" by EIEs and EIMEs, by requiring them to refrain from also being engaged in raising/managing "(public/private) securities investment funds". While CSRC's Interim Regulation along with the *Securities Investment Funds Law* generally set out requirements and threshold for entities that are eligible to manage and participate in securities investment funds. We are of the view that NDRC rules and CSRC rules are regulating investments/businesses of two separate areas, with NDRC being more upfront in regulating EIEs and EIMEs. From policy-making perspective, both rules do not have any substantial collision, save for some further unified cooperation of two governmental departments. The bright side of this is that NDRC's prohibition on EIEs and EIMEs' participation in "raising and managing public and/or private securities investment funds" sets clear the policies regarding EIEs and EIMEs to a certain extent, preventing administration chaos in a field where relevant laws and regulations are not mature enough.

Under the current policies, EIMEs may nevertheless apply for public fund qualification in accordance with CSRC's Interim Regulation. In order to achieve this, an EIME may have a non-EIME entity which is affiliated to it under the same corporate group or brand to accumulate the experiences in securities investment management, until the requirements under the Interim Regulation are met. For actual practices, we recommend that you make adequate communication with competent authorities and legal professionals when structuring deals, in order to avoid any non-compliance with Circular 694 or other regulations and rules regarding EIE/EIME administration.

1. For details please refer "Comments on the Interim Regulation on the Participation of Asset Management Entities in Public Securities Investment Funds — Issued Related to the Application by Private Fund Management Entities for Public Fund Qualification by Sandra Lu and Desmond An, published on Llinks" Asset Management Law Review, (March 2013 Issue). <http://www.llinksllaw.com/shangchuan/2013326135002.pdf>.
2. Extracts from the article 《发改委棒喝公募进程: 遭众 PE 强烈反弹 称其抢夺监管权》, published on 21ST CENTURY BUSINESS HERALD (《21 世纪经济报道》), issued on March 27, 2013, and the article 《发改委禁令难阻 PE 公募: 证监会招揽会员欲“打架”?》, published on 21ST CENTURY BUSINESS HERALD (《21 世纪经济报道》), issued on March 31, 2013.
3. Section 16.2 of the Interim Regulation on the Participation of Asset Management Entities in Public Securities Investment Funds provides that "the application of fund management qualification by equity investment management entities, venture capital management entities and other asset management entities which are in compliance with Section 5 and 8 hereof, shall be undergone in accordance with this Regulation".

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