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Shanghai Issued Measures for Pilot Projects of Foreign-invested Equity Investment Enterprises

By David Yu, Nicholas Lou and Teddy Li

Since 1 March 2010, the implementation of *the Measures for Administration of Establishment of Partnership Enterprises by Foreign Enterprises or Individuals in China issued by the PRC State Council* and *the Administrative Rules for Registration of Foreign-invested Partnerships* promulgated by the State Administration for Industry and Commerce of the PRC, foreign-invested limited partnership enterprise as a new form of foreign investment has drawn extensive attention of domestic and foreign investors. However, in practice, the foreign-invested partnership enterprises are encountering several difficulties such as the approval and administration problems, foreign exchange conversion barriers and etc.

Recently, Shanghai Financial Service Office ("**Shanghai FSO**"), Shanghai Municipal Commission of Commerce ("**MOFCOM Shanghai**") and Shanghai Administration for Industry & Commerce ("**SAIC Shanghai**") have jointly issued *the Implementation Measures for Pilot Projects of Foreign-invested Equity Investment Enterprises in Shanghai* (the "**Pilot Measures**", Hu Jin Rong Ban Tong [2010] No.38), which would come into effect thirty days from its issuance. Thus, the Pilot Measures which have triggered a hot market discussion are eventually promulgated.

1. Conditions and Requirements of Incorporation

The said Pilot Measures stipulate the conditions and requirements of the incorporation of foreign-invested equity investment enterprises ("**FIEIEs**") and foreign-invested equity investment management enterprises ("**FIEIMEs**"), which are summarized as below:

1.1 FIEIMEs.

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With regard to the FIEIEs, Shanghai Pudong New Area issued and implemented *the Pilot Measures for Foreign-invested Equity Investment Management Enterprise in Shanghai Pudong New Area* in 2009 (the "**2009 Pudong Rules**"). Therefore, we will explain the new rules on FIEIME by means of making a comparison between the Pilot Measures and the 2009 Pudong Rules.

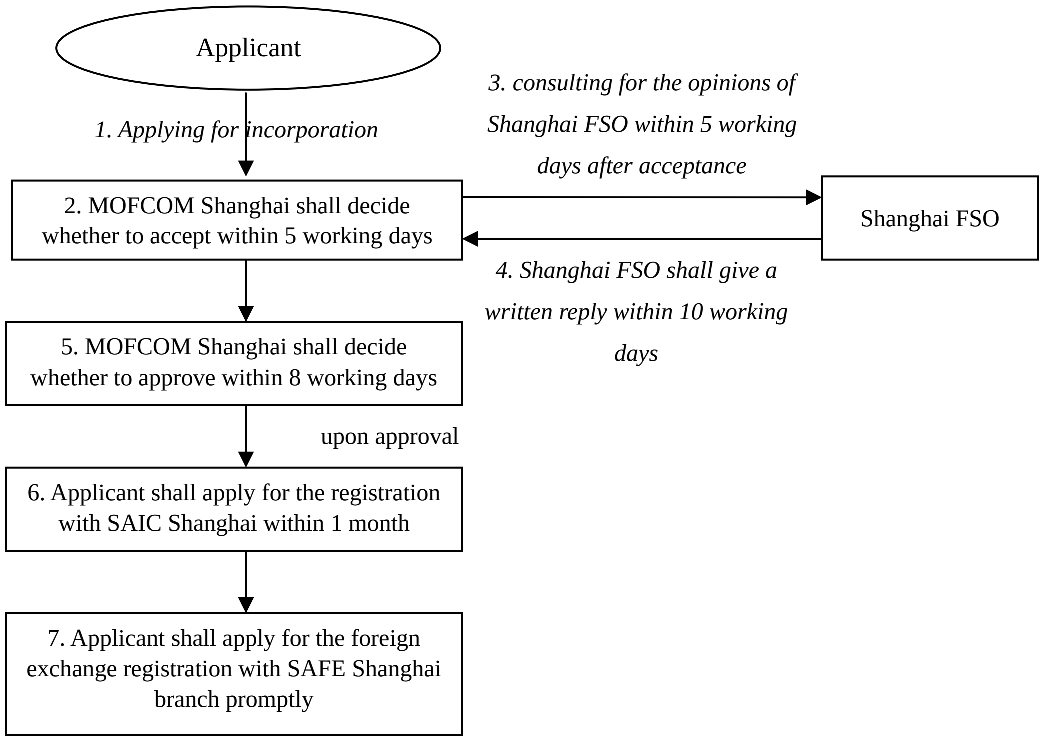
Items \ Regulations	Pilot Measures	2009 Pudong Rules
Name of Enterprise	words "equity investment fund management" are required	words "equity investment management" may be included
Form of Enterprise	a FIEIME can be incorporated in the form of company and partnership	a FIEIME can be incorporated in the form of CJV, EJV and WFOE; the form of partnership was not explicitly included
Minimum Registered Capital (or Subscribed Capital) and Payment Requirements	no less than USD 2 million, and initial 20% shall be actually paid-up within 3 months from the SAIC's issuance of the business license and the remaining shall be paid-up within 2 years. The capital contribution shall be paid-up in the monetary form only	no less than USD 2 million and initial 20% shall be actually paid-up within 3 months from the SAIC's issuance of the business license and the remaining shall be paid-up within 2 years (the form of capital contribution was not mentioned)
Permitted Businesses (description of the business scope)	business in which a FIEIME is allowed to be involved includes: ➢ raising and incorporating the equity investment enterprises; ➢ accepting the entrustment of the equity investment enterprises to conduct the management of its investment and provide relevant services; ➢ providing consulting services to equity investment; ➢ other business permitted by the approval or registration authorities	business scope of a FIEIME is "to accept the entrustment of a FIEIE to conduct the businesses of management and provide consulting services with respect to the equity investment"
Conditions for Application of Incorporation	➢ have at least one investor (shareholder), and the business scope of such investor (shareholder) or its **affiliated entity**[1] covers equity investment or equity investment management	
	➢ have at least two senior officers who shall meet the following qualifications simultaneously: (1) have five or more years' experience in equity investment or equity investment management;	➢ have at least two senior officers who shall be satisfied with the following qualifications simultaneously: (1) have two or more years' experience in equity investment or equity investment management;

Regulations / Items	Pilot Measures	2009 Pudong Rules
	(2) have two or more years' working experience as senior officer; (3) have experience in equity investment related to China or have the working experience in PRC financial institutions; (4) have no record of violating the regulations or pending lawsuit regarding economic disputes, and have good personal credit report in recent five years	(2) have two or more years' experience in equity investment or equity investment management; (3) have two or more years' working experience as senior officer.

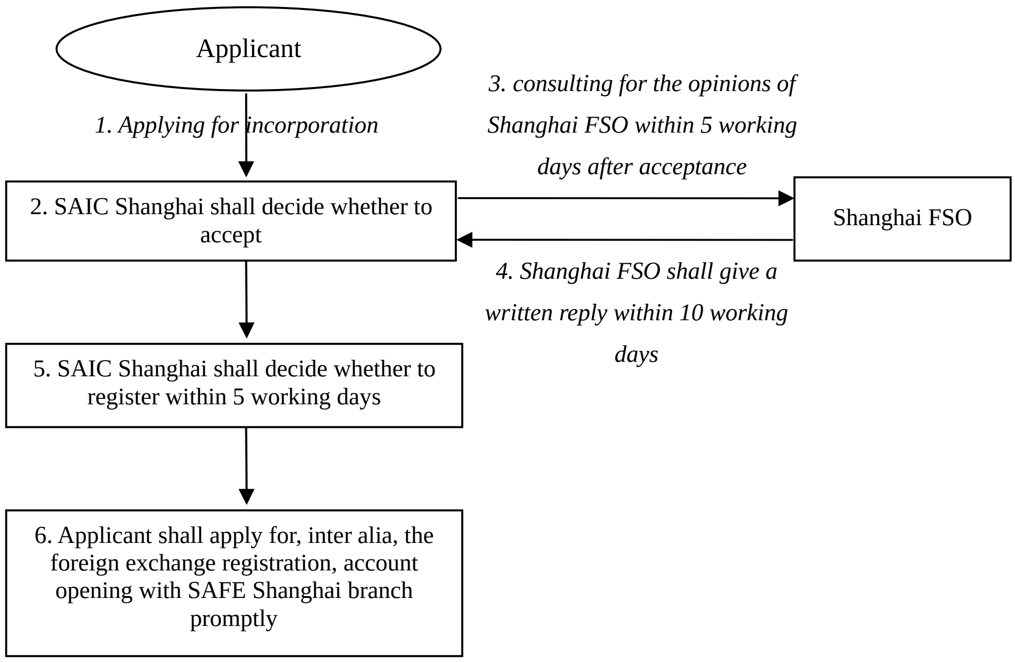
Based on the above comparison, it is our view that the Pilot Measures to be implemented in Shanghai are more detailed and concrete than the 2009 Pudong Rules, and they have set up more thresholds for the incorporation of a FIEIME. Given that the 2009 Pudong Rules were repealed on 30 June 2010, incorporating a FIEIME in Shanghai will be subject to the relevant provisions of the Pilot Measures.

According to the relevant provisions of the Pilot Measures, the approval procedures of a FIEIME are explained as follows:

- **In the form of company**



- **In the form of partnership**



1.2 FIEIE

The Pilot Measures also expressly provide the conditions and requirements of the incorporation of a FIEIE, which are summarized as below:

Name of Enterprise	words “equity investment fund” are required
Form of Enterprise	the form of partnership is expressly allowed
Minimum Subscribed Capital and Payment Requirements	no less than USD 15 million; partners shall make the contributions in their own names. Save for general partner (GP), the contribution of each limited partners (LP) shall be no less than USD 1 million and shall be paid-up in the monetary form only
Permitted Businesses (description of the business scope)	business in which a FIEIE is allowed to be involved includes: ➢ within the business scope permitted by the State, using all the self-owned capital to conduct the equity investment, including establishing new enterprises, acquiring the equity of established enterprises and other forms permitted by laws and regulations; ➢ providing consulting services to the invested enterprises; ➢ other relevant business permitted by the registration authority
Capital Custody	➢ A FIEIE shall appoint a domestic qualified bank as custodian; ➢ The custodian bank appointed by the FIEIE shall file its custodian system with the relevant competent authority

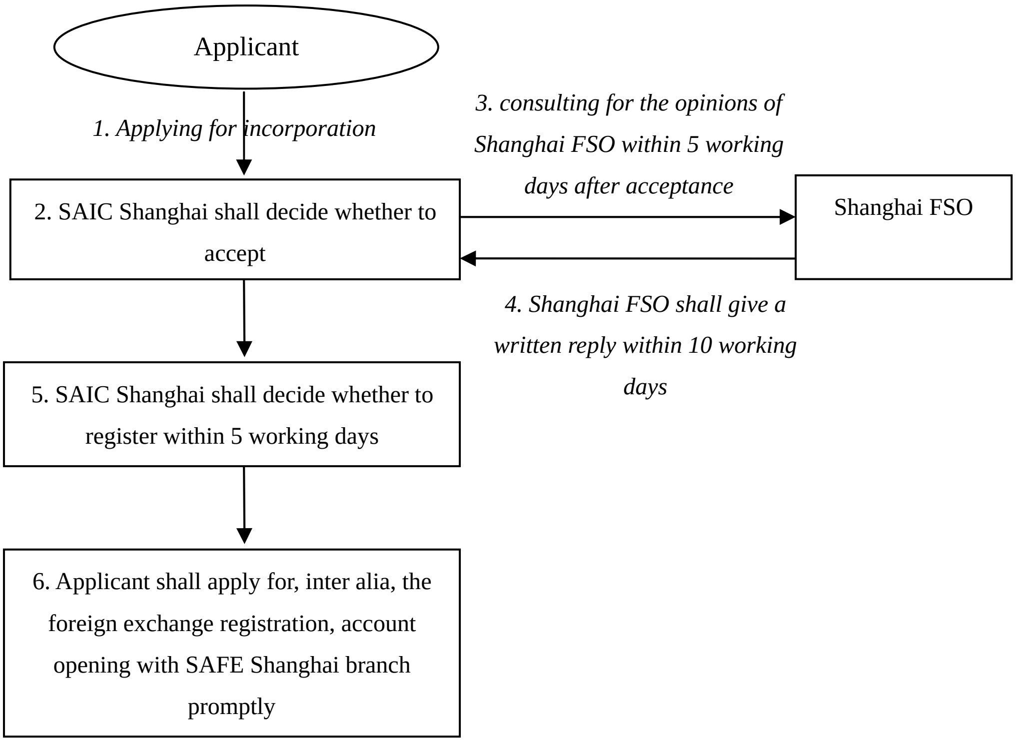
Notwithstanding that it is stipulated FIEIEs are primarily established in the form of partnership, the Pilot Measures do not exclude other forms such as company.

Regarding the established foreign-invested enterprises ("FIEs") which intend to incorporate or invest in FIEIEs or FIEIMEs, the matters set forth below need to be taken into consideration:

(1) according to Article 36 of the Pilot Measures, if an established FIE intends to invest in a FIEIE or FIEIME in the form of company in Shanghai, it shall apply for the MOFCOM Shanghai's approval according to the *Investment Within China by Foreign Investment Enterprises Tentative Provisions* (MOFCOM and SAIC 2000 Order No. 6);

(2) if an established FIE intends to invest in a FIEIE or FIEIME in the form of partnership, it shall apply to SAIC Shanghai according to the approval procedures promulgated by the Pilot Measures.

According to the relevant provisions of the Pilot Measures, the approval procedures of a FIEIE in the form of partnership are explained as follows:



2. Pilot Enterprises

Besides the abovementioned general foreign-invested equity investment enterprises, the Pilot Measures have also regulated the pilot enterprises of foreign-invested equity investment enterprises ("**Pilot Enterprises**"), and expressly provided the regulations on investment and filing of the Pilot Enterprises. Meanwhile, the Pilot Measures have provided the definition of the "Joint Meeting" for the first time and confirmed the mechanism that Shanghai FSO was a leading approval authority. More details are set forth below:

Definition of Pilot Enterprise	Specific FIEIE and FIEIME as reviewed and approved by the Joint Meeting[2]
Scope of Qualified Foreign Investors	Primarily consisted of foreign sovereign funds, pension funds, endowment funds, chartable funds, fund of fund (FOF), insurance companies, banks, securities companies and other foreign institutional investors approved by the Joint Meeting
Capital Custody	The capital of the Pilot Enterprises shall be in special custody, the capital account and usage of the proceeds in the account shall be in the custody of the custodian bank according to the relevant regulation
Qualifications of Foreign Investors	➢ Within the last accounting year before the application, the amount of the self-owned assets shall be no less than USD 500 million or the assets under its management shall be no less than USD 1000 million; ➢ Have sound governance structure and internal control system, and have not been imposed penalties by the judicial authority or relevant administrative authority in recent two years; ➢ Foreign investor or its affiliated entity shall have five or more year's experience in relevant investment; ➢ Other qualifications required by the Joint Meeting
Qualifications of Executive Partner	The executive partner or its affiliated entity shall have three or more years' sound experience in direct or indirectly investment in domestic enterprises in China
Approval Procedures	➢ The Shanghai FSO decides whether to accept or not within 5 working days after receiving the application; ➢ After deciding to accept the application , Shanghai FSO shall convene the relevant members of the Joint Meeting for review and approve the applicant as the Pilot Enterprise; ➢ The approved Pilot Enterprise shall complete the registration with SAIC Shanghai within six months from the approval, otherwise it shall re-apply for the approval regarding qualification of the Pilot Enterprise
Investment Capital	➢ Qualified FIEIME as a Pilot Enterprise is entitled to using its foreign currency to pay for its subscribed capital in the equity investment enterprise within the amount of 5% of the total subscribed capital of equity investment enterprise. Such capital contribution in foreign currency by the qualified FIEIME will not affect the original identification of the equity investment enterprise; ➢ Qualified FIEIE is entitled to applying to the custodian bank for conversion of its foreign currency into RMB to conduct the equity investment
Filing Requirement	The Pilot Measures also provide the Pilot Enterprise (including a FIEIE and a FIEIME) shall be subject to the following filing requirements: ➢ The Pilot Enterprise shall be filed with the finance service administration authority in the district (county) of Shanghai; ➢ The Pilot Enterprise shall report the material event[3] in the operation of the investment to finance service administration authority in the district (county) of Shanghai every six months

3. Restrictions on the Investment Area or Business

The Pilot Measures also provide the following investment area or business where a FIEIE is prohibited from being involved:

- investment in prohibited industries by the State;
- stocks and corporate bonds trade in a secondary market save the shares for which FIEIE is a holder in the enterprise becoming listed;
- investment in derivatives such as futures;
- investment, directly or indirectly, in real estate which is not for own use;
- appropriating non-self owned funds to make investment;
- providing loans to or security for other persons; and
- any other activities prohibited by PRC laws, regulations and incorporation documents of foreign-invested equity investment enterprises.

It is worth mentioning that the Pilot Measures expressly provide that "investment, directly or indirectly, in real estate which is not for own use" should be prohibited. In a nutshell, foreign-invested real estate equity investment is not allowed. Given that the Shanghai Municipal Housing Support and Building Administration Bureau is also the member of the Joint Meeting, it is our view that Shanghai FSO and the Joint Meeting will be more convenient to monitor the investment of foreign-invested equity investment in the real estate sector from the respect of the practical administration.

4. Issues Not Covered by the Pilot Measures

4.1 Nature of the Investment of FIEIEs

It is stipulated in Article 18 of the Pilot Measures that the equity investment of a FIEIE in PRC shall be subject to the relevant laws, administrative regulations and rules governing foreign investment. This provision is consistent with the provision in the *PRC State Council* and *the Administrative Rules for Registration of Foreign-invested Partnerships* promulgated by the State Administration for Industry and Commerce of the PRC.

However, the Pilot Measures fail to clarify the underlying meaning of words "shall be subject to the relevant laws, administrative regulations and rules governing foreign investment". In respect of this issue, relevant official from the SAIC explained that the investment made by a FIEIE is subject to approval and filing procedures applicable to foreign investors, which are similar to the procedures of foreign-invested company with investment nature or foreign-invested venture capital enterprise to a certain extent[4]. In other words, the target company will be deemed as a foreign-invested enterprise ("**FIE**") and require the certificate of approval of foreign-invested enterprise. However, there is no relevant regulation issued by the MOFCOM to confirm the above interpretation.

This issue is also related to the FIEIE foreign exchange conversion policies. Where the SAFE eventually grants its local branch or custodian bank the authority to review and approve the conversion of FIEIE's foreign currency into RMB (Please refer to paragraph 4.2 of this article) for the equity investment in China, it is not appropriate to consider the equity investment of the FIEIE as a foreign direct investment. To the contrary, it may be more suitable to consider such investment of the FIEIE as a domestic investment of a FIE. Nevertheless, to address this controversial issue will be dependent upon the rules or opinions of the competent MOFCOM (not the relevant administration of foreign exchange).

Therefore, from practical perspective, the approval procedures will depend upon the confirmation and understanding of the MOFCOM Shanghai or other competent local MOFCOM of the place where the target companies are incorporated, at the same time being dependent upon the FIEIE foreign exchange conversion policies to a certain extent.

4.2 FIEIE Foreign Exchange Conversion Policies

The foreign exchange conversion policies have attracted the attention of the market consistently. However, as the issuers of the Pilot Measures do not include SAFE, the details of the implementing rules of the FIEIE foreign exchange conversion policies, e.g. the quota and detail procedures of the foreign exchange conversion, will subject to the further clarification by SAFE.

According to the recent news, it is said that SAFE may be fixed Shanghai and Beijing as the first group of the pilot cities and grant approximately USD 3 billion quota respectively to the two cities for foreign exchange conversion. It is also said that the detailed conversion procedures would be as follows:

- the qualified Pilot Enterprise shall apply to the local financial service bureau or office;
- after approved, the qualified Pilot Enterprise will be granted a quota for foreign exchange conversion;
- within such quotas, the qualified Pilot Enterprise can apply to the custodian bank for the conversion of the foreign currency into its custodian account and use the converted RMB to do the investment.

In case the aforesaid news is finally confirmed, the feasibility of foreign exchange conversion under the Pilot Measures shall be highly enhanced.

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1 With respect to the definition of affiliated entity, the Pilot Measures still use the same definition of the 2009 Pudong Rules, which refers to the certain entity controlled by, controlling or under common control with the investor. However, the Pilot Measures do not clarify that "control means the controller owns more than 50% voting rights in the entity being controlled", which was expressly stated in the 2009 Pudong Rules.

2 According to the relevant provisions of the Pilot Measures, Joint Meeting refers to a joint working meeting system set up by the Shanghai Municipal People's Government. It is convened by the leader taking in charge of the matters in the Shanghai Municipal People's Government, and its members are consisted of Shanghai FSO, MOFCOM Shanghai, SAIC Shanghai, NDRC Shanghai, Shanghai Municipal Commission of Economy and Informatization, Science and Technology Commission of Shanghai Municipality, Shanghai Finance Bureau, Shanghai Local Taxation Bureau, Shanghai Municipal Housing Support and Building Administration Bureau, Legislative Affairs Office of Shanghai Municipal People's Government, SAFE Shanghai Branch, CBRC Shanghai Bureau, CSRC Shanghai Bureau, People's Government of Shanghai Pudong New Area and etc. The office of Joint Meeting is set up in Shanghai FSO.

3 According to the relevant provisions of the Pilot Measures, such "material events" refers to (i) investment of the FIEIE; (ii) investment of the FIEIME; (iii) amending of the important legal documents such as joint venture contract, articles of association, partnership agreement and etc.; (iv) the change of the senior management; (v) the alteration of the FIEIME entrusted by a FIEIE; (vi) increase or decrease the registered capital (subscribed capital); (vii) division or merger; (viii) dissolution, liquidation or bankruptcy; (ix) other matters required by the Shanghai FSO.

4 According to Article 19 of the *MOFCOM's Provisions on the Establishment of Companies with an Investment Nature by Foreign Investors* (modified in 2004), the investment of a foreign-invested companies with investment nature shall be subject to the approval level and approval procedures applicable to the FIE. According to the Chapter 7 of the *Provisions on the Administration of Foreign-invested Venture Capital Investment Enterprises (*"**FIVCIE**"*)*, Investment activities by FIVCIEs within China shall be handled with reference to the provisions of the *Guiding the Direction of Foreign Investment Provisions* and the *Foreign Investment Industrial Guidance Catalogue*. When investing in any enterprise that falls into the encouraged or permitted industry category, a FIVCIE shall file a report for record with the authorized local MOFCOM and obtaining a Foreign-invested Enterprise Approval Certificate. When investing in any enterprise that falls into the restricted industry category, a FIVCIE shall apply to the provincial competent MOFCOM for approval.