New Company Law:
Key Takeaways and Action Plan for PFM

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On 29 December 2023, the seventh session of the Standing Committee of the 14th National People's Congress adopted the *Company Law of the People's Republic of China (Revised in 2023)* ("**New Company Law**"), which will take effect on 1 July 2024. The New Company Law only provides a grace period for capital contribution of existing companies while there is no "grandfathering" for other matters. From 1 July 2024, all the newly-incorporated and existing companies shall fully comply with the New Company Law.

Compared with the currently-effective *Company Law of the People's Republic of China (Amended in 2018)* ("**Current Company Law**"), the New Company Law introduces changes relating to various aspects such as incorporation and exit of company, capital system, governance structure, rights and responsibilities of shareholders, directors, supervisors and senior management personnel ("**SMPs**"). In general, the moves to be made according to the New Company Law by a private fund manager ("**PFM**") incorporated in the form of a limited liability company ("**LLC**") mainly covers the following:

- If the registered capital of the PFM has not been fully paid up, make capital contribution for the outstanding amount within the grace period or reduce the registered capital as appropriate;
- Verify whether the existing capital contribution certificates and the register of shareholders comply with the requirements under the New Company Law;
- Evaluate the current corporate governance structure, make optimization and adjustment as appropriate;
- Revisit and revamp the articles of association ("**AoA**");
- Revisit relevant internal policies especially from the aspects of related-party transaction, co-investment, dual-hatting, etc., make amendments or inputs as appropriate;
- Enhance the awareness of the shareholders, directors, supervisors and SMPs on their rights and responsibilities, take corresponding internal control measures.

This article introduces the key changes of the New Company Law noteworthy for PFMs and the impact on the PFMs brought thereby mainly from the above perspectives. In view of the fact that most PFMs are incorporated in the form of LLC, this article focuses on LLC related provisions under the New Company Law.

I. Capital System

Under the Current Company Law, there is no statutory term for the shareholders of an LLC to make capital contribution. Article 47 of the New Company Law amends such provision and introduces a 5-year maximum capital contribution time limit, i.e., the shareholders of an LLC must fully inject the registered capital that they subscribe for within 5 years from the incorporation date of the LLC according to the AoA.

If a new LLC is to be incorporated to apply for PFM registration, before formally setting up the legal entity, it is necessary to determine a reasonable amount of registered capital by taking into account the New Company Law and relevant legislations governing private fund sector, and set an appropriate capital contribution schedule in the AoA. According to the *Measures for Registration and Filing of Private*

Investment Funds (私募投资基金登记备案办法, "**Registration and Filing Measures**") and the *Guidelines for Registration of Private Fund Managers No.1 – Basic Requirements for Business Operation* (私募基金管理人登记指引第 1 号——基本经营要求), the application for PFM registration shall be submitted to the Asset Management Association of China ("**AMAC**") within 12 months from the date when the incorporation of the legal entity is registered with the Administration for Market Regulation ("**AMR**"). The shareholder(s) of a PFM shall make capital contribution in cash, and the paid-in capital shall not be less than RMB10 million or its equivalent in a freely convertible currency. In determining the registered capital of a new PFM, on the one hand, the amount should at least reach the minimum requirement stipulated by PFM related legislations and meet the actual needs for its operation; on the other hand, to freely determine the registered capital or put an excessively high figure should be avoided, otherwise the shareholder(s) may be faced with a burdensome capital contribution obligation.

For existing PFMs that have been registered with AMAC, the capital contribution schedule stipulated in their AoA is usually not tight, while it is quite rare to see that the shareholders of a PFM are required to make capital contribution in full within 5 years from the company incorporation date. Meanwhile, some PFMs are gradually acquiring stable cash flows and maintaining adequate working capital with the development of their private fund business, in which case there is not much urgency to require additional capital injection from the shareholders. Many PFMs in the market currently still have unpaid registered capital. As the New Company Law does not provide "new-old cut" arrangements for capital contribution of existing LLCs, the PFMs whose registered capital has not been fully paid up may take different steps in light of their actual needs:

1. Capital Injection within the Grace Period

Article 266, paragraph 2 of the New Company Law stipulates that "If a company has been incorporated and registered before this Law comes into force, and the capital contribution period exceeds the period specified by this Law, the company shall, unless otherwise provided by laws, administrative regulations or the State Council, gradually make adjustment to ensure that the capital contribution period is not longer than the period specified in this Law. If the capital contribution period or amount is obviously abnormal, the company registration authority may require timely adjustment according to law. The State Council will issue specific implementation measures in this regard".

On 6 February 2024, the State Administration for Market Regulation released the *Provisions of the State Council on the Implementation of the Registered Capital Registration Management System under the Company Law of the People's Republic of China (Consultation Paper)* (国务院关于实施<中华人民共和国公司法>注册资本登记管理制度的规定(征求意见稿), "**Provisions of the State Council on Registered Capital System (Consultation Paper)**"). The Provisions of the State Council on Registered Capital System (Consultation Paper) sets a 3-year grace period in accordance with Article 266 of the New Company Law, which is from 1 July 2024 to 30 June 2027. If the capital contribution schedule of a company incorporated prior to the effectiveness of the New Company Law is not in compliance with the New Company Law, the company shall make rectification within the prescribed grace period. Specifically:

- If the remaining period for making full capital contribution of an LLC incorporated before the New Company Law becomes effective is less than 5 years from 1 July 2027, it is not necessary to adjust the capital contribution schedule. In other words, if the longstop date of capital contribution stipulated in the current AoA is earlier than 30 June 2032, the shareholder(s) can still follow the current AoA to make capital contribution in full.

- If the remaining period for making full capital contribution of an LLC incorporated before the New Company Law becomes effective is more than 5 years from 1 July 2027, the remaining capital contribution period shall be adjusted to within 5 years during the grace period. The adjusted capital contribution schedule shall be specified in the AoA and disclosed to the public on the National Enterprise Credit Information Publicity System (国家企业信用信息公示系统, "**AMR System**") according to law. In other words, if the longstop date of capital contribution stipulated in the current AoA is later than 30 June 2032, the capital contribution schedule shall be adjusted before 30 June 2027 with the adjusted longstop date being no later than 30 June 2032.

If an LLC incorporated prior to the effectiveness of the New Company Law fails to adjust the capital contribution schedule after the grace period expires, the company registration authority may, according to law, require the LLC to make rectification within 90 days. The capital contribution period shall not exceed 5 years from 1 July 2027 (i.e., the longstop date shall not be later than 30 June 2032). In addition, if a company fails to adjust its capital contribution schedule in accordance with the foregoing transitional arrangements, the company registration authority will put a special remark in terms of such situation on the AMR System and disclose the same to the public.

For PFMs whose registered capital has not been fully paid up, their rectification can generally be covered by the following scenarios:

- If additional capital injection is still needed and the longstop date of capital contribution stipulated in the AoA is not later than the prescribed deadline under the transitional arrangements, it is not necessary to adjust the capital contribution schedule. The shareholder(s) can still follow the provisions of the current AoA to pay the outstanding capital contribution.

- If additional capital injection is still needed but the longstop date of capital contribution stipulated in the AoA is later than the prescribed deadline under the transitional arrangements, it is necessary to amend the AoA to adjust the capital contribution schedule. The shareholder(s) shall follow the adjusted schedule to make capital contribution in full.

- If all things considered, there is no need of capital injection in the short term, the PFMs may consider reduction of the registered capital. If further capital injection is needed in the future, the PFMs can increase the registered capital then. As such, the shareholder(s) can avoid being faced with the pressure to make full capital contribution by the hard deadline.

It is advisable for the PFMs to determine the rectification plan as early as possible by taking into account the company's capital, ongoing operation status, and the ability of the shareholder(s) to make capital injection.

2. Reduction of Registered Capital

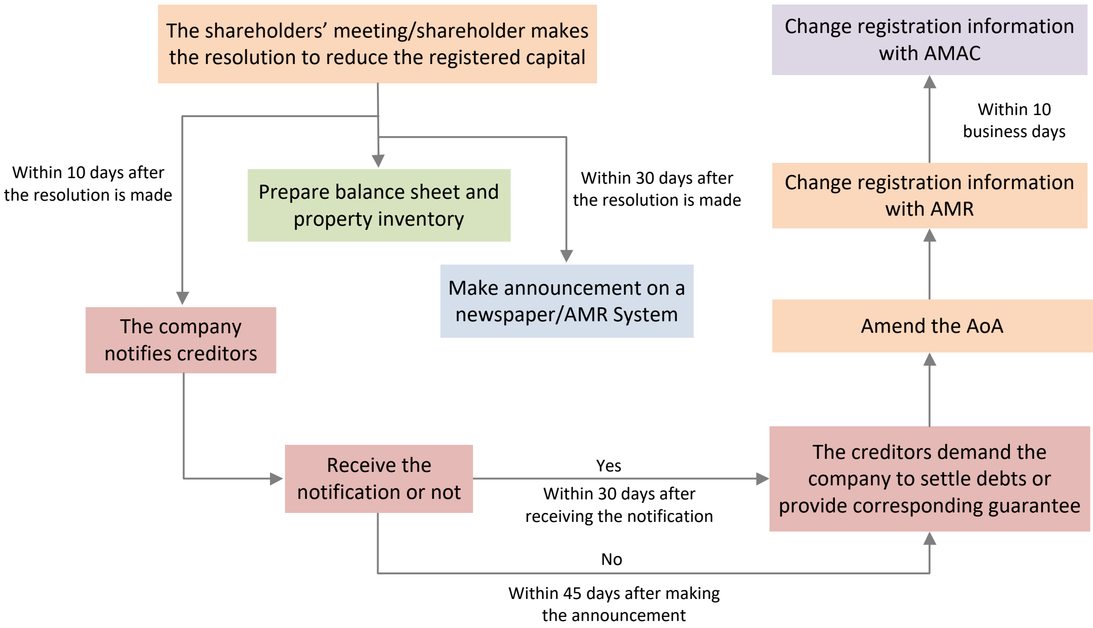
If a PFM decides to reduce its registered capital, when to initiate the capital reduction procedure is one of the issues to be considered. Unless otherwise provided, if the capital reduction is conducted before 1 July 2024, relevant procedures shall still be carried out in accordance with the Current Company Law; if the capital reduction is conducted after 1 July 2024, the provisions under the New Company Law shall apply.

The New Company Law refines the capital reduction rules under the Current Company Law, including, without limitation, introducing the classification of ordinary capital reduction procedure and expedited capital reduction procedure, liability for illegal capital reduction. For the ordinary capital reduction procedure, the New Company Law basically inherits the rules under the Current Company Law, while it further clarifies that the capital shall be reduced according to the shareholders' capital contribution on a *pro rata* basis unless it is otherwise agreed by all the shareholders of an LLC. The expedited capital reduction procedure newly introduced by the New Company Law could be applied provided that the prescribed conditions are met. Moreover, the New Company Law stipulates the prerequisites of the expedited capital reduction procedure and it is not allowable to waive the capital contribution obligation of any shareholder through the expedited capital reduction procedure.

It is noteworthy that the Provisions of the State Council on Registered Capital System (Consultation Paper) also stipulates the capital reduction arrangements during the grace period. If an LLC applies for the reduction of registered capital during the grace period without any refund of paid-in capital, it may be subject to a simplified procedure provided that relevant conditions are met. Please refer to point (3) below for details.

(1) Ordinary Capital Reduction Procedure

The chart below shows the key steps of the ordinary capital reduction procedure:



In terms of the ordinary capital reduction procedure, the PFMs need to pay attention to the following matters:

- The resolution to reduce the registered capital must be adopted by the shareholders representing at least 2/3 voting rights, and in case of a wholly-owned PFM, the resolution shall be made by its sole shareholder.

- Although the announcement on the AMR System is not stipulated in the Current Company Law, this is not a way which can be applied only after the New Company Law takes effect. The *Implementing Rules for the Administrative Regulation of the People's Republic of China on the Registration of Market Entities* (中华人民共和国市场主体登记管理条例实施细则) effective from 1 March 2022 already makes it clear that the announcement on reduction of a company's registered capital can be made through the AMR System.

- According to the Registration and Filing Measures, if the registered capital of a PFM changes, the PFM shall undergo the change of registration information with AMAC within 10 business days after completing the AMR procedure. Additionally, as the change of registered capital leads to amendment to the AoA, the PFM also needs to upload the latest AoA onto the Asset Management Business Electronic Registration System ("**AMBERS System**"). The update of AoA can be completed together with other matters when the PFM makes annual update.

(2) Expedited Capital Reduction Procedure

Article 225 of the New Company Law introduces a new expedited capital reduction procedure, allowing a company to reduce its registered capital without notifying its creditors, and accordingly without any need to settle debts or provide corresponding guarantee based on the creditors' demand. But the announcement on capital reduction shall be made on a newspaper or the AMR System within 30 days after the shareholders' meeting/shareholder makes the resolution to reduce the registered capital. If a company has used profits and reserves to make up for its losses but there are still losses, then the company can make up for its losses by way of reducing its registered capital. The company can make up for its losses through the expedited capital reduction procedure, provided that (i) the company shall not make any distribution to the shareholders, (ii) the shareholders' obligation to pay the outstanding capital contribution shall not be exempted, and (iii) the company shall not distribute profits until the aggregate amount of statutory reserve and discretionary reserve reaches 50% of the company's registered capital.

For example: assuming that for Company A, the registered capital is RMB50 million, the paid-in capital is RMB40 million (RMB10 million of the registered capital has not yet been paid up), there are still losses of RMB30 million after making up for its losses legally, and without taking other factors into consideration, the current owner's equity is RMB10 million. According to Article 225 of the New Company Law, RMB30 million can be allocated from "paid-in capital" to "undistributed profits", then "paid-in capital" becomes RMB10 million, "loss" becomes zero, and the owner's equity remains RMB10 million. The registered capital of Company A should be reduced to RMB20 million accordingly, but the shareholders' obligation to pay the outstanding RMB10 million of the registered capital shall not be exempted. To put it in another way, the expedited capital reduction procedure is only a way to beautify a company's financial statements, i.e., the paper loss is reduced without actually changing the company's net assets. This will not affect the creditors' interests, and therefore, the exemption of notification to the creditors is somehow reasonable.

(3) Special Capital Reduction Arrangements During the Grace Period

According to the Provisions of the State Council on Registered Capital System (Consultation Paper), if a company incorporated prior to the implementation of the New Company Law applies for the reduction of registered capital without refund of paid-in capital during the grace period (from 1 July 2024 to 30 June 2027), the company can make an announcement to the public through the AMR System for 20 days provided that the following conditions are met, and if no objection is raised by the creditors during the 20-day public announcement period, the company can handle the change of registered capital with AMR simply by submitting the application letter and the commitment letter: (i) the company does not have outstanding debts or the company's debts are significantly lower than its paid-in capital; (ii) all the shareholders undertake to bear joint and several liability for the company's debts prior to the capital reduction to the extent of their originally subscribed capital contribution; (iii) all the directors undertake not to jeopardize the company's ability to settle its debts and continue as a going concern.

If a PFM only reduces the amount of registered capital that has not yet been paid up without the return of any paid-in capital to its shareholder(s), and satisfies the above-mentioned conditions, it can undergo a simplified procedure, i.e., no need to prepare the balance sheet and property inventory, no need to notify its creditors, and the public announcement period is only 20 days. If the return of paid-in capital is involved or any of the above-mentioned conditions is not satisfied, the capital reduction shall be handled in accordance with Article 224 (ordinary capital reduction procedure) or Article 225 (expedited capital reduction procedure) of the New Company Law.

3. Increase of Registered Capital

Many existing companies are currently planning capital reduction, mainly with an aim to avoid the pressure on the shareholders to pay the outstanding capital contribution in the short term after the New Company Law takes effect. However, if there is a genuine need of capital injection in the future, the registered capital can be further increased. Therefore, the provisions relating to capital increase under the New Company Law also deserve attention.

(1) Procedural Requirements for Capital Increase

Similar to capital reduction, the resolution to increase the registered capital must be adopted by the shareholders representing at least 2/3 voting rights, and in case of a wholly-owned PFM, the resolution shall be made by its sole shareholder. The company shall amend the AoA and conduct change registration with AMR. The PFM shall undergo the change of registration information with AMAC within 10 business days after completing the AMR procedure, and upload the amended AoA onto the AMBERS System in a timely manner.

Additionally, it should be noted that if a PFM has multiple shareholders, unless otherwise agreed by all the shareholders, the shareholders shall have the preemptive right to subscribe for the increased registered capital in proportion to the capital contribution paid up by them on the same terms.

(2) Schedule to Pay the Increased Registered Capital

Article 228, paragraph 1 of the New Company Law stipulates that “when an LLC increases its registered capital, the contribution by its shareholders to the new registered capital shall be made in accordance with relevant provisions of this Law regarding the payment of capital contribution for the incorporation of an LLC”. The Provisions of the State Council on Registered Capital System (Consultation Paper) also stipulates that “the newly increased registered capital of an LLC shall be paid up within 5 years”. However, it still begs further clarification on how to calculate the 5-year period (namely, starting from the date of the resolution made by the shareholders’ meeting/shareholder or the date of change registration with AMR) in the implementation measures to be issued in the future.

For a PFM, after the shareholder(s) pay the new registered capital: (i) on the one hand, the PFM needs to update the publicly-disclosed information of paid-in capital through the AMR System; (ii) on the other hand, the PFM shall undergo the change of registration information with AMAC through the AMBERS System within 10 business days and upload the supporting document regarding the paid-in capital (e.g., bank slip).

(3) Conversion of Reserves into Registered Capital

Both the Current Company Law and the New Company Law allow the conversion of a company's reserves into registered capital. But to convert the statutory reserve into registered capital, the amount of the retained statutory reserve shall not be less than 25% of the company's registered capital before the conversion. Some PFMs may still have unpaid registered capital but have already withdrawn a sufficient amount of reserves, and they hope to offset the outstanding subscribed capital contribution that has not been paid up by the shareholders by converting the reserves into registered capital. However, this plan is not workable. The usage of the reserves should be limited to making up for the company's losses, expanding the company's business or converting into **registered capital**, which may not be set off against the outstanding subscribed capital contribution with an aim to release the shareholders from the capital contribution obligation in disguised form.

4. Other Matters of Concern

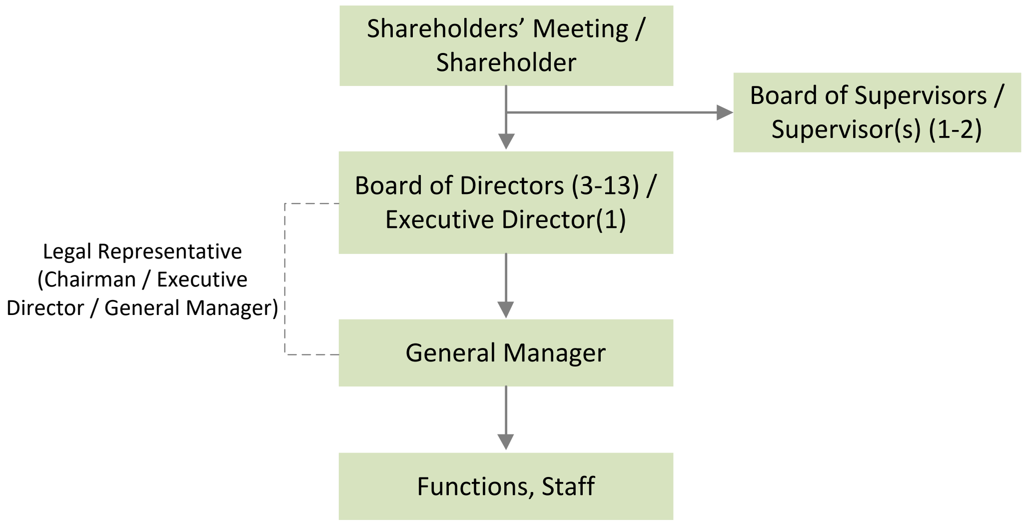
In addition to the analyses above, the following changes regarding the capital system in the New Company Law also deserve the PFMs' attention:

- Both the amount of capital contribution subscribed for and already paid up by the shareholders shall be stated on the capital contribution certificate. Apart from the company chop, the capital contribution certificate shall also include the signature of the legal representative. The requirements on the capital contribution certificate stipulated in the AoA of certain PFMs may not be aligned with the New Company Law, which need to be amended.

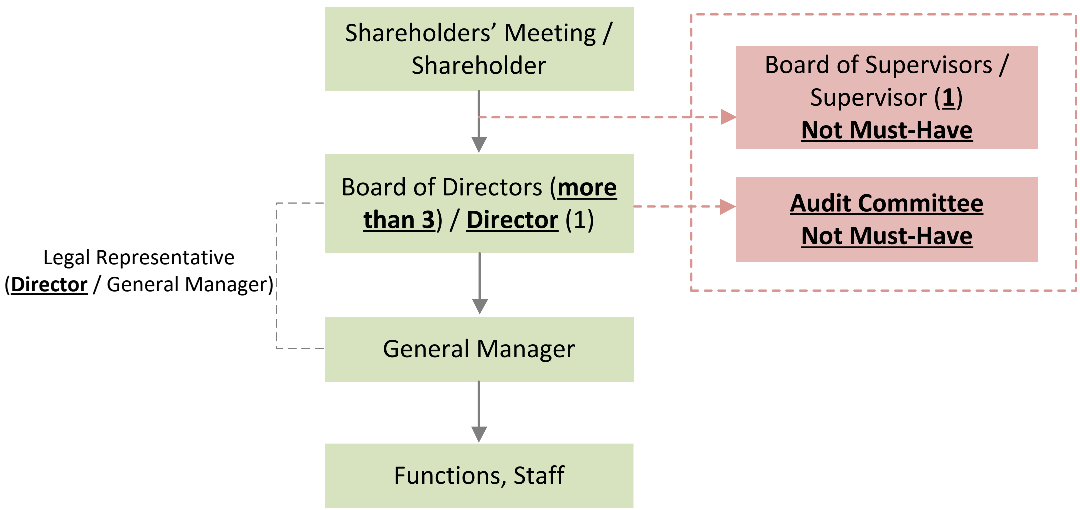
- The amount of capital contribution subscribed for and already paid up by the shareholders, the way and date for the shareholders to make capital contribution shall be clearly stated in the register of shareholders. The PFMs should verify the existing register of shareholders prepared by them and supplement relevant information as necessary.

II. Corporate Governance Structure

The New Company Law revises the requirements on the corporate governance structure of a company. The common corporate governance structure of an LLC under the Current Company Law is as below:



The New Company Law introduces more flexibility on the corporate governance structure of an LLC:



1. Shareholders’ Meeting/Shareholder

(1) Voting Rights Required for A Resolution of the Shareholders’ Meeting

The New Company Law introduces the number of voting rights required for adopting a general resolution by the shareholders’ meeting, i.e., “being adopted by the shareholders representing a majority of the voting rights”. If the provisions in the AoA of a PFM are in conflict with such requirement, the AoA should be amended, otherwise a resolution of the shareholders’ meeting may be “invalid” because the number of voting rights to adopt the resolution fails to reach the percentage as prescribed in law.

A wholly-owned PFM will not be affected by the above revision, and the decisions on both general matters and special matters shall be made by its sole shareholder in writing.

(2) Changes to Statutory Powers of the Shareholders' Meeting/Shareholder

The New Company Law optimizes the statutory powers of the shareholders' meeting/shareholder, removing the power "to determine the company's operating strategies and investment plans" and the power "to review and approve the company's annual financial budget plan and final accounts plan", and introducing that the shareholders' meeting/shareholder can "authorize the board of directors to approve the issuance of corporate bonds". The PFMs may either amend their AoA in accordance with the foregoing changes or still keep the existing arrangements in light of their actual situation.

2. Board of Directors/Director

(1) Setup of the Board of Directors and Appointment of Director

In the New Company Law, the maximum number of directors is scrapped, and it is still allowable for an LLC of a small scale or having a small number of shareholders to opt to have a sole "director" to exercise the powers of the board of directors (the term "executive director" is no longer a legal concept under the New Company Law).

Overall, the above revision will have little impact on the current arrangements of the PFMs in respect of the board of directors/director. Howsoever, in the subsequent revamp of the AoA, it is still necessary to pay attention to whether relevant provisions therein will be affected. By way of example, for a company that has only one "executive director" currently, if it still chooses not to establish the board of directors, it needs to revise the description "executive director" into "director" globally in the AoA.

(2) Changes to Statutory Powers of the Board of Directors/Director

The New Company Law removes the statutory power of the board of directors "to formulate the company's annual financial budget plan and final accounts plan", and introduces that the board of directors can exercise "powers authorized by the shareholders' meeting". It is also clarified that any restrictions on the powers of the board of directors set out in the AoA may not be asserted against any *bona fide* third party.

The flexibility has already been built in the AoA of many PFMs, providing that the board of directors/director may exercise other powers authorized by the shareholders' meeting/shareholder. If there are not such miscellaneous provisions, the PFMs may consider including the flexibility in the subsequent revamp of the AoA.

(3) Departure of Director

The New Company Law clarifies that the departure of a director includes two scenarios, comprising (i) resignation of the director, and (ii) removal by the shareholders' meeting/shareholder:

- The resignation of a director shall take effect on the date when the company receives the written notice of resignation, provided that, if the departure of the director will lead to the number of directors falling below the quorum, he/she shall continue to perform duties until a newly-appointed director takes office.

- The removal of a director shall take effect on the date when the resolution of the shareholders' meeting/shareholder is made. But the director may require the company to make compensation if he/she is removed prior to the expiration of his/her term of office without any justifiable reason.

The AoA of the PFMs usually does not cover detailed arrangements about the departure of a director. In the subsequent revamp of the AoA, the PFMs may consider the addition of such content as appropriate. However, even if the AoA is not amended, such provisions in the New Company Law can be applied directly after the New Company Law takes effect.

Moreover, the AoA of certain PFMs (especially wholly-owned companies) may provide that the shareholder has the right to remove a director without any reason. After the New Company Law takes effect, the shareholder shall be cautious in exercising this right. In the event that a director is removed without justifiable reason, he/she is entitled to claim compensation.

(4) Rules of Procedure of the Board of Directors

The New Company Law introduces the statutory minimum requirement on the quorum of a board meeting and the votes necessary for adopting a board resolution, i.e., "a majority of the directors must be present to constitute the quorum of a board meeting", "the affirmative votes of a majority of all the directors are required to adopt a resolution of a board meeting". If a PFM has the board of directors but the rules of procedure thereof are not aligned with the foregoing provisions of the New Company Law, it is necessary to make amendment, otherwise a resolution of the board of directors may be "invalid" because the number of directors present at the board meeting or the number of affirmative votes to adopt the resolution fails to reach the percentage as prescribed in law. To take an example, if the quorum for a board meeting and the required affirmative votes for adopting a board resolution provided in the AoA is "one-half or more", conflict with the New Company Law will exist in the event of an even number of directors.

A PFM that opts to only have one director will not be affected by the above revision, and the decisions on relevant matters shall be made by its sole director.

(5) Employee Director

The New Company further extends the requirement of having employees' representative in the board of directors. In general, it is optional for the board of directors to have employees' representative. Under the following conditions, the board of directors must include employees' representative: (a) a wholly State-owned company; or (b) a company which has more than 300 employees and does not establish the board of supervisors.

For a PFM not wholly owned by the State of which the number of employees does not reach 300, it is not required to have an employee director.

3. Board of Supervisors/Supervisor

(1) Single-Layer Governance Is Allowable, No Longer Mandatorily Required to Have the Board of Supervisors/Supervisor

The New Company Law allows LLCs that meet certain conditions to dispense with the board of supervisors or supervisor:

- General conditions: according to Article 69 of the New Company Law, with the setup of an audit committee (which is composed of directors) under the board of directors to exercise the powers of the board of supervisors/supervisor, the setup of the board of supervisors or the appointment of a supervisor can be exempted.

- Special conditions: according to Article 83 of the New Company Law, an LLC of a small scale or having a small number of shareholders is permitted to have one supervisor in lieu of the board of supervisors, or even not to have any supervisor at all if all the shareholders unanimously consent.

Although there is no clear interpretation of "small scale" and "small number of shareholders" in practice, we understand that most PFMs may be able to leverage Article 83 of the New Company Law to dispense with the board of supervisors or supervisor considering that (i) the PFMs, especially the foreign-invested PFMs, mostly have a single-digit number of shareholders (except for certain JV PFMs, most foreign-invested PFMs only have a sole shareholder), (ii) many PFMs tend to adopt a simple departmental setup and staffing without a big corporate scale. That is to say, the most streamlined governance structure of a PFM meeting the prescribed conditions can include only one director, without the board of directors and the board of supervisors/supervisor.

If a PFM intends not to retain any supervisor, the unanimous consent of all the shareholders is required. The shareholders' meeting/shareholder shall make a resolution to remove the supervisor(s) and amend the AoA of the PFM. The PFM shall then undergo AMR procedure for information change.

(2) No Longer Feasible to Have Two Supervisors

Under the Current Company Law, an LLC of a small scale or having a small number of shareholders can opt to have one or two supervisors in lieu of the board of supervisors. The New Company Law reduces the number of supervisor(s) (in the absence of the board of supervisors) to one. The PFMs currently not establishing the board of supervisors but having two supervisors may consider the following approaches to make rectification: (a) to establish the board of supervisors (no less than 1/3 of the board members shall be employees' representative); (b) to remove one supervisor (if the company still intends to retain the position of supervisor); or (c) not to retain any supervisor upon unanimous consent of all the shareholders. The foregoing rectification will also involve removal of supervisor, amendment to the AoA and AMR procedure for information change.

(3) Statutory Powers of the Board of Supervisors/Supervisor

Compared with the Current Company Law, the New Company Law does not make substantive changes to the statutory powers of the board of supervisors/supervisor. But the New Company Law introduces the safeguard for duty performance by the board of supervisors/supervisor, i.e., the board of supervisors/supervisor may request the directors and SMPs to submit the reports on the performance of their duties.

If a PFM continues to have the board of supervisors/supervisor, it may consider incorporating the above requirements in the subsequent revamp of the AoA.

(4) Voting Rights Required for A Resolution of the Board of Supervisors

The New Company Law introduces the number of voting rights required for adopting a resolution by the board of supervisors, i.e., "being adopted by a majority of all the supervisors". If a PFM has the board of supervisors and the provisions in the AoA of the PFM are in conflict with such requirement, the AoA should be amended, otherwise a resolution of the board of supervisors may be "invalid" because the number of the voting rights to adopt the resolution fails to reach the percentage as prescribed in law.

4. General Manager

The statutory powers of the general manager are deleted in the New Company Law. The New Company Law states that the general manager shall exercise the powers stipulated in the AoA or authorized by the board of directors. If the AoA of a PFM has provided the powers of the general manager in accordance with the Current Company Law, in the subsequent revamp of the AoA, it may revisit and restate the powers of the general manager in the light of the company's actual situation.

5. Legal Representative

(1) Election of Legal Representative

The New Company Law expands the candidate pool for the position of legal representative such that any director who handles corporate affairs on behalf of the company or the general manager may serve in this position. The PFMs will have more flexibility in electing the legal representative, provided that the legal representative must satisfy the eligibility requirements under the Registration and Filing Measures, the *Guidelines for Registration of Private Fund Managers No.3 – Legal Representative, Senior Management Personnel, Executive Partner or Its Appointed Representative* (私募基金管理人登记指引第 3 号——法定代表人、高级管理人员、执行事务合伙人或其委派代表) as well as other PFM related legislations.

Besides, the New Company Law requires that the AoA shall specify how to appoint and change the legal representative. The AoA of most PFMs currently only provides who serves as the legal representative. In the subsequent revamp of the AoA, it is necessary to supplement the method to appoint and change the legal representative.

(2) Resignation of Legal Representative

The New Company Law introduces the rules on resignation and reappointment of the legal representative. If a director or the general manager who serves as the legal representative resigns his/her position, he/she shall be deemed to have resigned as the legal representative at the same time, in which case the company shall appoint a new legal representative within 30 days from the date of resignation.

The PFMs also need to pay attention to the following issues:

- The legal representative shall not be changed before completing the filing of the first private fund.

- Within 10 business days after the change of the legal representative, the PFM shall undergo the information change procedure with AMAC.

- Except for the PFMs controlled by institutions regulated by the offshore financial regulators and other PFMs that meet the prescribed requirements, the legal representative of a PFM shall hold a certain percentage of the equity interest in the PFM, which means that the resignation of the legal representative will also involve the disposal of equity interest. Considering the time for the disposal of equity interest and the eligibility requirements applicable to the legal representative under the PFM related legislations, it will not be an easy thing for a PFM to meet the "30-day" time limit of reappointing a legal representative under the New Company Law.

(3) Liability Arising from the Legal Representative's Behaviors

The New Company Law introduces the provisions concerning the assumption of liability arising from the legal representative's behaviors. In the event that the legal representative causes damage to other persons while performing his/her duties, the company shall assume the civil liability. After assuming the civil liability, the company may, according to law or the AoA, claim indemnification against the legal representative who is at fault. In terms of the foregoing provisions, the PFMs may consider providing the specific circumstances and procedures in the AoA for claiming indemnification against the legal representative at fault.

III. Rights and Responsibilities of the Shareholder

1. Further Enhancement on the Shareholder's Right to Know

Compared with the Current Company Law, the New Company Law emphasizes more on the protection of the shareholder's right to know, which is mainly embodied in the following aspects:

- Introducing the shareholder's right to inspect and copy the company's register of shareholders;
- Introducing the shareholder's right to inspect the company's accounting vouchers (under the Current Company Law, only the company's accounting books, financial and accounting reports can be inspected by the shareholder);
- Introducing that the shareholder can appoint an intermediary to assist in the exercise of the inspection right;
- Introducing the shareholder's right to inspect and copy relevant materials of the company's wholly-owned subsidiaries.

2. Extension of the Shareholder's Rights to the Company's Wholly-owned Subsidiaries

In addition to the extension of the shareholder's right to know to the company's wholly-owned subsidiaries, the shareholder's derivative action is also extended to the company's wholly-owned subsidiaries. According to Article 189 of the New Company Law, if (i) any of the directors, supervisors and SMPs of a wholly-owned subsidiary of a company is found to violate laws, administrative regulations or the subsidiary's AoA while performing duties, which causes losses to the subsidiary, or (ii) any other person infringes the subsidiary's legitimate rights and interests and causes losses, the shareholder may request in writing the board of supervisors/supervisor or the board of directors/director of the subsidiary to file a lawsuit with the people's court or file a lawsuit directly with the people's court in the shareholder's own name.

The *Measures for Supervision and Administration of Private Investment Funds (Consultation Paper)* (私募投资基金监督管理办法(征求意见稿)) stipulates that, if a PFM has to set up a subsidiary for the management of the private funds' assets, the subsidiary shall be included in the unified compliance and risk control management of the PFM. The group's unified management is implemented under the "WFOE PFM + QDLP subsidiary" structure (which is more common among global asset managers) due to the sharing of personnel, office, etc. The extension of the shareholder's rights to the wholly-owned subsidiaries of a company under the New Company Law provides a further legal basis for the aforesaid arrangements.

3. Forfeiture of Equity Interest due to Failure to Make Timely Capital Contribution

Article 51 and Article 52 of the New Company Law introduce the mechanism regarding forfeiture of the shareholders' equity interest due to failure to make timely capital contribution. If the board of directors finds that a shareholder fails to make capital contribution on time, the company shall issue a written demand letter to the relevant shareholder calling for the payment of the outstanding amount. The defaulting shareholder shall make payment within the grace period (which should be no less than 60 days from the date of the written demand letter); failing to do so, the company (upon resolution of the board of directors) may issue a notice to the defaulting shareholder regarding forfeiture of equity interest corresponding to the unpaid registered capital from the date of the notice. The forfeited equity interest shall be transferred according to law, or cancelled by way of capital reduction; if such transfer or cancellation is not completed within 6 months, other shareholders of the company (if any) shall make up for the outstanding capital contribution (which should have been made by the defaulting shareholder) in proportion to their respective capital contribution in the company.

The PFMs may consider specifying the grace period for payment of the outstanding capital contribution and the defaulting shareholder's obligation to cooperate in the AoA or the shareholders' agreement (if any), so as to have the basis to rely on in the event that a shareholder fails to make timely capital contribution.

4. Accelerated Maturity of Capital Contribution by the Shareholder

As there is no mandatory capital contribution timeline under the prevailing laws and regulations, the shareholders enjoy the benefits generated during the period when they choose not to make capital contribution at will. The shareholders are only liable to make immediate contribution in circumstances where a company is liquidated or made bankrupt. However, Article 54 of the New Company Law goes much further, with the condition triggering the shareholders' making immediate capital contribution adjusted to "the company is unable to discharge the debts when they become due". It is advisable for a PFM and its shareholder(s) to pay attention to the PFM's debts (especially in the event that the registered capital has not yet been fully paid up), so as to avoid triggering the obligation of the shareholder(s) to make early capital contribution due to the inability to settle the debts as they fall due.

5. Rules for "Horizontal" Piercing the Corporate Veil

Article 23 of the New Company Law stipulates that, if a shareholder battens on two or more companies under its "control" to evade debts, which leads to serious prejudice to the interests of the companies' creditors, each company shall bear joint and several liability for the debts of the other companies. The Registration and Filing Measures and other legislations governing the private fund sector also put forward requirements on segregation of business risks, avoidance of horizontal competition, management of related-party transactions, prevention of conflicts of interest, etc. in terms of two or more PFMs controlled by the same controlling shareholder or actual controller. Furthermore, AMAC is expected to release tailor-made guidelines for collectivized PFMs, which deserves continuous attention.

A PFM needs to maintain independence from other entities controlled by its controlling shareholder or actual controller, in order to avoid triggering the assumption of joint and several liability. If the controlling shareholder or actual controller breaches the law, the registration of the PFM (in case of a newly-incorporated company) or the filing of private funds (in case of an existing PFM) may be adversely affected.

IV. Rights and Responsibilities of Directors, Supervisors and SMPs

1. Expansion of Fiduciary Duty of Directors, Supervisors and SMPs

(1) Duty of Loyalty and Duty of Diligence

The New Company Law clarifies for the first time the connotation of "duty of loyalty" and "duty of diligence" owed by directors, supervisors and SMPs. The "duty of loyalty" means that "the directors, supervisors and SMPs shall take measures to avoid conflicts between their own interests and the company's interests, and shall not use their powers to seek improper benefits". The "duty of diligence" means that "the directors, supervisors and SMPs shall exercise reasonable care normally expected of managers in the best interests of the company when performing their duties".

(2) Management of Related-party Transactions Conducted by Directors, Supervisors and SMPs

Compared with the Current Company Law, the New Company Law expands the scope of related-party transactions and strengthens the rules on management of related-party transactions. Specifically:

- The scope of related persons is expanded from directors and SMPs to (a) directors, supervisors, SMPs; (b) close relatives of directors, supervisors, SMPs; (c) enterprises directly or indirectly controlled by directors, supervisors, SMPs or their close relatives; and (d) persons having other affiliated relationship with directors, supervisors, SMPs.

- The scope of related-party transactions further covers indirect transactions, i.e., related-party transactions include directly or indirectly concluding contracts or conducting transactions with the company.

- The requirements on reporting and approval of related-party transactions are introduced. Any related-party transaction shall be reported to the board of directors or the shareholders' meeting, and shall be subject to the approval of the board of directors or the shareholders' meeting according to the AoA.

- It is clarified that affiliated directors shall recuse themselves from voting; if the number of non-affiliated directors present at the board meeting is less than 3, the related-party transaction shall be submitted to the shareholders' meeting for review and approval.

From the perspective of AMAC registration, the related parties shall be disclosed in accordance with relevant legislations governing the private fund sector such as the *Guidelines for Registration of Private Fund Managers No.2 – Shareholder, Partner, Actual Controller* (私募基金管理人登记指引第 2 号——股东、合伙人、实际控制人) as well as the instructions shown on the AMBERS System. From the perspective of defining related parties and managing related-party transactions at the company's level, it may be necessary for the PFMs to improve the current mechanism for management of related-party transactions in conjunction with the requirements of the New Company Law. Specifically:

- The scope of persons and transactions governed by the existing policies should be revisited and extended as needed.

- If the AoA does not specify the mechanism for approval of the related-party transactions conducted by directors, supervisors and SMPs, it is suggested to include it in the powers of the board of directors/director or the shareholders' meeting/shareholder as appropriate. If the related-party transactions are to be reviewed and approved by the board of directors/director, the rules on recusal from voting shall be followed.

(3) Restrictions on Seeking Business Opportunities Belonging to the Company, Engaging in Business Competing with the Company's Business by Directors, Supervisors and SMPs

Under the Current Company Law, without the consent of the shareholders' meeting, the directors and SMPs shall not take advantage of their positions to seek business opportunities belonging to the company for themselves or other persons, and shall not engage in the same type of business as that of the company for themselves or other persons. Article 183 and Article 184 of the New Company Law also include supervisors in the scope of persons subject to the foregoing restrictions, and allow the AoA to authorize the board of directors to approve such matters provided that the affiliated directors shall recuse themselves from voting (if the number of non-affiliated directors present at the board meeting is less than 3, the relevant matter shall be submitted to the shareholders' meeting for review and approval). Besides, the New Company Law introduces an exception for seeking business opportunities of the company, which is that "the company is unable to exploit the business opportunities according to laws, administrative regulations or the AoA".

The following matters are worthy of attention for PFMs:

- If the AoA does not specify the mechanism for approval of the circumstances where the directors, supervisors and SMPs seek business opportunities of the company or engage in business that competes with the company's business, it is suggested to include it in the powers of the board of directors/director or the shareholders' meeting/shareholder as appropriate. If the relevant matters are to be reviewed and approved by the board of directors/director, the rules on recusal from voting shall be followed.

- Article 16 of the *Measures for Supervision and Administration of Private Investment Funds (Consultation Paper)* provides that, where the controlling shareholder, general partner, actual controller, SMPs and investment management personnel of a PFM use their proprietary funds to make investment, the relevant persons shall not take advantage of their positions or make use of the PFM's facilitating conditions for running business. This article should be primarily for the purpose of avoiding conflict of interest or transfer of benefits that damages the interests of other investors, while it does not prohibit the co-investment by such persons. Although such co-investment behavior will not certainly be characterized as "seeking business opportunities of the company for themselves or other persons", from a prudent point of view, it is suggested that the PFMs formulate and improve the co-investment policy. In order to avoid any dispute on the compliance with the procedural requirements stipulated in Article 183 of the New Company Law, the PFMs may consider approving the co-investment policy by a resolution of the shareholders' meeting or the board of directors.

- Subject to the regulatory requirements in the private fund sector, the directors, supervisors and SMPs of a PFM may be dual-hatted with an affiliated PFM that conducts the same type of business. In this case, it is suggested to follow the requirements of the New Company Law, reporting to the board of directors or the shareholders' meeting and seeking the approval of the board of directors or the shareholders' meeting according to the AoA.

2. **Responsibility of Directors, Supervisors and SMPs to Maintain Capital Adequacy**

(1) **Obligation of Directors to Demand the Shareholders to Make Timely Capital Contribution**

Article 51 of the New Company Law introduces the obligation of the board of directors to demand the shareholders to make timely capital contribution. The responsible directors shall be personally liable to the company for any losses resulting from the delinquent capital contribution of the shareholders.

In order to implement such obligation of the board of directors/director, the PFMs may consider specifying in the AoA the right of the board of directors/director to verify and supervise the shareholders' fulfillment of capital contribution obligation. Also, the PFMs can purchase D&O insurance for the directors.

(2) **Liability of Directors, Supervisors and SMPs for Compensation**

The New Company Law enhances the responsibility of directors, supervisors and SMPs to maintain adequacy of a company's capital in the course of the company's operation. In addition to the liability of the responsible directors in the event of non-payment of capital contribution by the shareholders as described above, in the event of losses to the company caused by the shareholders' withdrawal of capital contribution, illegal capital reduction, or illegal distribution of profits, the directors, supervisors and SMPs who are held responsible shall be liable to pay compensation.

3. **Liability of Directors and SMPs to Compensate Third Parties**

Article 191 of the New Company Law introduces the liability of the directors and SMPs for damages caused to other persons in performing their duties. Where any director or SMP causes any damage to any other person in the performance of duties, the company shall be liable for compensation; if the director or SMP is intentional or has gross negligence, he/she shall also be liable for compensation. It should be noted that, unlike the case of the legal representative (where the legal representative causes damage to other persons while performing his/her duties, the company shall assume the civil liability first, and then, may claim indemnification against the legal representative at fault), the third parties are entitled to demand compensation directly from the director or SMP who is at fault.

V. Definition of Controlling Shareholder and Actual Controller

The Registration and Filing Measures defines the "controlling shareholder" in line with the Current Company Law, i.e., "a shareholder whose capital contribution accounts for 50% or more of the total capital in the case of an LLC, or a shareholder whose shares account for 50% or more of the total share capital in the case of a company limited by shares; or a shareholder whose capital contribution or share proportion is less than 50% of the total capital or share capital but whose voting rights are sufficient to exert a material influence on resolutions of the shareholders' meeting". The New Company Law revises the requirement on shareholding percentage from "50% or more" (50% inclusive) to "more than 50%" (50% exclusive). According to the *Legislation Law of the People's Republic of China* (中华人民共和国立法法), "the effect of laws is higher than that of administrative regulations, local regulations and rules". It is obviously that the effect of laws is higher than that of self-disciplinary rules. We understand that the revision to the definition of the "controlling shareholder" under the New Company Law shall apply to the private fund sector as well.

Compared with the Current Company Law, the New Company Law deletes the wordings "though not being a shareholder of the company" from the definition of the "actual controller", i.e., "any person who can exert actual control over a company through any investment relationship, agreement or other arrangement". This means that a shareholder of a company may be its actual controller concurrently. The definition of the "actual controller" in the Registration and Filing Measures is in line with the New Company Law. Moreover, the special rules on how to identify the actual controller under the private fund system are also worthy of attention. For instance, the actual controller of a foreign-invested PFM shall be traced to the regulated foreign financial institution.

VI. Transfer of Equity Interest

Under the Current Company Law, the transfer of equity interest by a shareholder to any person other than a shareholder of the company shall first be approved by a majority of the other shareholders. The New Company Law removes this requirement and clarifies the specific matters to be notified by a selling shareholder, which include quantity, price, method of payment and period of time for the intended transfer, etc. In the meantime, the New Company Law also clarifies the capital contribution liability of transferor and transferee: (1) if there is any outstanding capital contribution relating to the equity interest to be transferred which is not yet due, the transferee shall bear the future contribution obligation after the transfer of equity interest; if the transferee fails to make the capital contribution when it becomes due, the transferor shall bear a secondary (not joint and several) liability to contribute the overdue capital; (2) if the capital contribution relating to the equity interest to be transferred was already due before closing, or the actual value of the non-monetary property used as capital contribution is significantly lower than the amount of capital contribution subscribed for, then the transferor shall remain liable for making the capital contribution even if the equity has been transferred and the transferee shall be jointly and severally liable for such contribution, unless the transferee is not aware and should not have been aware of such overdue contribution.

In case of the transfer of any equity interest in a PFM, the factors to be taken into account include the capital contribution ability of the transferee, and more importantly, whether the transferee can meet the eligibility requirements applicable to the shareholders of PFMs. The Registration and Filing Measures also clearly requires that, if a shareholder of a PFM intends to transfer any equity interest held by it, it shall have a strong understanding of the transferee's financial condition, professional ability, integrity status, etc., and inform the transferee of relevant regulatory and self-disciplinary requirements for acting as a shareholder of the PFM.

Additionally, if the transfer of equity interest leads to the change of controlling shareholder or actual controller of a PFM, the PFM shall undergo the change procedure with AMAC within 30 business days from the date of change, and submit a special legal opinion in terms of the captioned change. In the event of change in actual control of a PFM, a legal opinion shall be submitted on whether the changed PFM is in full compliance with the requirements for PFM registration, and the AUM of such PFM in the 12 months prior to the captioned change must be no less than RMB30 million on a continuous basis.

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