

LEGAL UPDATE

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NDRC Issued New Nationwide Circular to Regulate the Development of Equity Investment Enterprises in China

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On November 23, 2011, National Development and Reform Commission of PRC (“NDRC”) issued the *Circular of the General Office of the National Development and Reform Commission on Promoting the Normalized Development of Equity Investment Enterprises* (Fa Gai Ban Cai Jin [2011] No. 2864, hereinafter the “**New Circular**”). Back to January, 2011, NDRC had issued *Circular of the General Office of the National Development and Reform Commission on Further Normalizing the Development and Filing Management Work of Equity Investment Enterprises in Pilot Areas* (Fa Gai Ban Cai Jin [2011] No. 253), which substantially regulated the filing and operation of the equity investment enterprises and their entrusted management enterprises in six pilot areas, namely Beijing, Tianjin, Shanghai, Jiangsu, Zhejiang and Hubei.

The New Circular addressed two significant matters: First, the mandatory record-filing administration system for equity investment enterprises and its entrusted management enterprises is officially expanded to the whole nation from the original pilot areas. As a result, all equity investment enterprises should submit a filing with relevant governmental authorities, and conduct its establishment, management, investment and other activities in compliance with the New Circular.

Second, the New Circular requires that equity investment enterprises with different capital scale should respectively file their records with NDRC or provincial record-filing authorities. Equity investment enterprises whose capital (including committed capital) reaches 500 million RMB (or equivalent foreign currency) should file their records with NDRC, and others should file their records with provincial authorities. In practice, the provincial record-filing authorities are often the provincial development and reform commissions or provincial financial offices.

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Notwithstanding the above, according to the New Circular, an equity investment enterprise is exempted from filing if it: (1) has already been filed as a venture capital investment enterprise in accordance with the *Interim Administrative Measures for Venture Capital Investment Enterprises*; or (2) is funded wholly by a single entity (including its wholly-owned subsidiaries) or natural person.

The New Circular restated NDRC's requirements on the establishment and operation of equity investment enterprises and equity investment management enterprises. Besides the above-mentioned record-filing requirements, other important rules include:

- 1) **Capital raising and establishment:** The capital of equity investment enterprises may only be raised from qualified investors through private placement. Investors shall subscribe for their capital contributions with their own legitimate monetary funds only; any non-monetary investment and bank loans are not permitted. The investment scope of equity investment enterprises is confined to non-publicly-traded shares or equity interests.

Where the investors are collective fund trusts, partnership enterprises and other institutions without a legal person status, the ultimate natural persons and legal persons must be verified as qualified investors, and the total number of such persons shall be counted in computing the number of investors. Nevertheless, eligible equity investment funds of funds may be considered as a single investor.

- 2) **Qualification of senior management personnel:** All the senior management personnel of an equity investment enterprise and its entrusted management entity shall have no records of illegal activities in the previous 5 years and are not involved into any pending litigation of major economic disputes, and at least three of them shall have two years or more of equity investment experience or relevant business experience.
- 3) **Requirements of assets custody:** Unless otherwise agreed by all the investors, the capital of the equity investment enterprise shall be put in custody of an independent institution.

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- 4) **Requirements of filing regular and special reports to record-filing authorities:** Within 4 months after each fiscal year, an equity investment enterprise shall submit an annual business report and an annual financial report audited by an accounting firm to the relevant record-filing authorities. The entrusted management institution and the custody institution shall submit an annual asset management report and an annual asset custody report to the relevant record-filing authorities.

Where any major event occurs during its investment operations, an equity investment enterprise must report to the record-filing authority within 10 working days. Major events include:

- (1) where the equity investment enterprise revises its or its entrusted management institution's articles of association or partnership agreement, the entrusted management agreement and other relevant documents;
 - (2) where the equity investment enterprise or its entrusted management institution changes the capital or takes debt financing from external parties;
 - (3) where the equity investment enterprise or its entrusted management institution undergoes a division or merger;
 - (4) where there is a change of the entrusted management institution or custodian of the equity investment enterprise, including changes of the senior management personnel of the entrusted management institution and other major changes; and
 - (5) where the equity investment enterprise enters into dissolution or bankruptcy proceedings or has its assets supervised by a receiver.
- 5) **Periodic and ad hoc inspections:** Record-filing authorities shall establish and improve the equity investment enterprises record-filing management information system, the whistle blowing system, regular and *ad hoc* inspections, public disclosure and other systems; For filed equity investment enterprises and their entrusted management institutions, the filing management authorities shall conduct an annual inspection, and monitor their operations through letters, telephone calls, visits, on-site inspection and off-site monitoring and other means where necessary.

The New Circular came into effect upon promulgation. Equity investment enterprises and their entrusted management institutions established prior to such effective date shall go through formalities for record-filing with relevant record-filing authorities within 3 months upon the promulgation of the New Circular. Equity investment enterprises whose investment operations are not in compliance with the New Circular shall make rectifications within 6 months after the promulgation date.

The New Circular demonstrates that NDRC determines to commence a sustained comprehensive supervision on private equity investment enterprises nationwide. **The equity investment enterprises in the original pilot areas whose capital is less than 500 million RMB shall file their records with local provincial record-filing authorities as early as possible and conduct an inspection on their internal compliance. Furthermore, all equity investment enterprises established outside of the pilot areas shall conduct record-filing as early as possible in compliance with the New Circular and conduct an inspection for their internal compliance.** Equity investment enterprises that fail to comply with the New Circular may face penalties from record-filing authorities or other serious consequences.

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