

An Overview of the New Shenzhen QFLP Program

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On Jan. 29, 2021, the Shenzhen Municipal Administration for Financial Regulation (the SMAFR) issued the Shenzhen City, Measures on the Pilot Foreign-Invested Equity Investment Enterprise Project (the New Measures) (深圳市外商投资股权投资企业试点办法), which represents the third iteration of the government's pilot scheme for qualified foreign-invested equity investment pilot enterprises (or more commonly known as qualified foreign limited partners, or "QFLPs") to have been issued over the past decade. The first version of the QFLP measures was promulgated in 2012, and entitled the Shenzhen City, Tentative Measures for the Launch of the Pilot Project Work for Foreign-Invested Equity Investment Enterprises (the 2012 QFLP Measures) (关于本市开展外商投资股权投资企业试点工作的暂行办法). These measures were followed in 2017 by a revised version entitled the Shenzhen City, Measures on the Pilot Foreign-Invested Equity Investment Enterprise Project (the 2017 QFLP Measures) (深圳市外商投资股权投资企业试点办法).

Compared with the 2017 QFLP Measures, the New Measures have brought about some important changes: they have relaxed the requirements which have to be met in order to achieve QFLP status, expanded the scope of QFLP businesses, and strengthened and streamlined the ongoing management of QFLP business and entities, all to a significant degree. The most significant revisions made in 2021 are summarized below.

1. Direct Investment by QFLP Fund Managers in Target Company

The New Measures have lifted the control that previously restricted QFLP fund managers from making direct investment in the target company. This policy change is in line with current regulatory and business practice in the Chinese private equity industry.

2. Rules on the Name and Business Scope of QFLP Fund Managers and Funds

The New Measures, closely following the current private fund legal requirements set by, among other regulators, the China Securities Regulatory Commission (the CSRC) and the Asset Management Association of China (AMAC), explicitly provide that the name or label given to QFLP fund managers and QFLP funds must meet the requirements of the relevant regulatory authorities. According to the Several Provisions on Strengthening the Oversight of Private Investment Funds (关于加强私募投资基金监管的若干规定) issued by the CSRC on Dec. 30, 2020, private fund managers must include in a fund's name a reference such as "private fund," "private fund management," or "venture capital investment", and must specify in a fund's business scope a reference which reflects the characteristics of the private funds managed by the fund managers, such as "private investment fund management", "private securities investment fund management," "private equity investment fund management," or "venture capital investment fund management".

3. Removal of Minimum Capital Contribution Requirements

The New Measures have removed the minimum registered capital or minimum subscribed capital contribution requirement for QFLP fund managers and the relevant restriction on the capital injection period, as well as the minimum subscribed capital contribution requirement for QFLP funds (collectively, the “Capital Contribution Requirements”). This relaxed regulation, in conformity with its counterparts in Guangzhou, Hainan and Beijing, will potentially make Shenzhen more attractive to applicants for the QFLP pilot scheme as compared to other jurisdictions where the rules are more rigid with respect to the registered capital or the subscribed capital contribution requirements for QFLP fund managers or funds. It is important to note, however, that some other pilot jurisdictions have all but no requirements in this regard and even explicitly provide in their QFLP measures that “there shall be no minimum registered capital or subscribed capital contribution requirement for QFLP fund managers and/or QFLP funds domiciled in the pilot jurisdictions”.

The Capital Contribution Requirements should not simply be perceived as putting the relevant pilot jurisdictions in a disadvantageous position. It does not stand to reason that a jurisdiction with some legal requirements in this respect will be inherently worse off in fostering QFLP business than one that has little or no requirements. China’s QFLP business, in the end, remains a trial program largely informed by various local factors. Requirements imposed with respect to the qualifications of QFLP fund managers and funds merely reflects the policy positioning of the relevant authorities in charge of the development of the QFLP business in each pilot jurisdiction.

4. Removal of Additional Requirements for Senior Management Personnel

The New Measures have removed specific requirements for senior management personnel engaged by QFLP fund managers, including minimum headcount, equity investment/equity investment management experience, and senior management working experience. In so doing, the New Measures have aligned themselves with those of Guangzhou, Xiamen and Beijing (where legal requirements exist primarily in principle). This policy relaxation has been made possible by the New Measures mainly out of the consideration that, with continuous improvement of private fund regulation in recent years, the current regulation has contained relatively comprehensive and specific requirements for senior management personnel of private fund managers. It is, therefore, necessary to relieve some burden imposed by the QFLP pilot measures on QFLP fund managers (for example, the human resource cost or other costs incurred in initiating and developing the QFLP business), thereby offering national treatment to QFLP fund managers and creating a level playing field for QFLP fund managers and their domestic peers alike.

5. Removal of Various Requirements for QFLP Fund Investors

The New QFLP Measures have also removed a number of requirements for QFLP fund

investors, especially requirements related to institutional investors' governance, internal controls and compliance, as well as in relation to offshore institutional investors' net assets and size of a single investment. This regulatory relaxation should go far to mitigate the fundraising difficulties experienced by QFLP fund managers, and enable them to broaden their client base. Apart from Shenzhen, some other pilot jurisdictions, including Guangzhou, Zhuhai and Hainan, already apply a relatively lower standard to QFLP fund investors. In addition, one specific provision of the 2017 QFLP Measures—which requires that a person's capital contribution as a percentage of the total capital contribution shall not be more than 50% if the person simultaneously controls a QFLP fund's general partner and limited partner—has also been removed.

6. Removal of Certain Requirements for Domestic Fund Managers

The New Measures have removed relevant requirements previously set for domestic fund managers who participate in the QFLP pilot scheme by raising QFLP funds from foreign investors. Domestic private fund managers intending to participate in the QFLP pilot scheme no longer need to submit documents to prove that they can meet relevant requirements provided in the 2017 QFLP Measures, including without limitation the domicile, registration time, and net assets/AUM. Following this policy relaxation, domestic fund managers and foreign investors alike have been given more choices and opportunities to participate in the QFLP pilot scheme.

7. Allowing QFLP Funds to Make Private Placement Investments

The New Measures have specified, for the first time ever, that QFLP funds can invest in privately-offered or privately-traded common shares of listed companies by participating in private placements of new shares of listed companies, conducting block trading, or entering transfer agreements with listed companies according to the relevant rules and procedures of stock exchanges, and that QFLP funds can accept allotment of shares in their capacity as listed companies' pre-IPO shareholders. This shift of position does not appear to be a newly-minted policy favorable for QFLP fund managers. Rather, it primarily reflects the SMAFR's efforts to identify and underscore the nature of QFLP funds as private equity funds (which naturally means that the investment scope of QFLP funds should be consistent with that of private equity funds), and to specify and reiterate, at a regulatory level, its legal position that QFLP funds may participate in M&A and restructuring of listed companies within the current fund regulatory framework. As early as October 2018, AMAC, in addressing media enquiries related to the ability of private equity investment funds to participate in M&A and restructuring of listed companies, explicitly stated that 'private equity investment fund' refers to a private fund that invests in the equity of unlisted companies, in privately-offered or privately-traded common shares of listed companies (by, among other means, participating in private placement of new shares of listed companies, conducting block trading, or entering transfer agreements with listed companies according to the relevant rules and mechanism of stock exchanges), and in convertible preference shares and convertible bonds of listed companies.

8. QFLP Funds May Adopt FOF Structure

The New Measures allow QFLP funds to adopt the fund of funds (FOF) structure. The 2017 QFLP Measures provided that “foreign-invested equity investment enterprises shall use the Foreign Investment Industrial Guidance Catalogue (外商投资产业指导目录) as guidance and invest in industries directly,” which in practice restricted QFLP funds from investing as FOF funds. The New Measures have lifted this restriction by making it clear that QFLP funds can invest in domestic private equity and venture capital funds, which in turn are encouraged to make direct investments in industries. This should not be regarded as a breakthrough of the current regulatory framework on private equity funds, but a legal relaxation within the regulatory framework designed to further broaden the investment scope of QFLP funds—a boon to QFLP fund business—and to narrow the gap between QFLP funds and other private equity FOF funds in the market. This policy change has empowered Shenzhen’s QFLP funds with an even more notable competing edge compared to other pilot jurisdictions. As of today, Zhuhai, for instance, continues to ban the FOF structure pursuant to its pilot measures; Likewise, Qingdao’s pilot measures prohibit investment from a master fund into a sub-fund, while in Guangzhou QFLP funds remain legally required to make direct investments in equity of domestic private companies.

9. Amendments to Custody Requirements

The requirements under the 2017 QFLP Measures that QFLP fund managers, QFLP funds and other RMB funds managed by QFLP fund managers delegate qualified commercial banks to act as their custodian banks have been terminated under the New Measures. Instead, the New Measures provide that “foreign-invested equity investment enterprises shall undertake the fund custodian business in accordance with the Tentative Measures for the Regulation of Private Investment Funds (私募投资基金监督管理暂行办法) and other relevant requirements of AMAC,” a provision consistent with the current private fund regulatory practices. In this regard, other pilot jurisdictions including Xiamen, Guangzhou, Chongqing and Shanghai take a relatively relaxed attitude. Xiamen’s and Guangzhou’s pilot measures are silent on the issue as to whether QFLP fund managers or QFLP funds should delegate a custodian bank, while their counterparts in Chongqing and Shanghai mainly require QFLP funds to delegate a custodian bank to take custody of the fund assets.

10. QFLP Funds May Adopt Dual GP Structure

A dual general partner structure is now permitted in a QFLP fund. In terms of the fund structure, the New Measures, closely following the private fund regulatory practices of AMAC, specifically allow a QFLP fund to adopt the dual general partner structure and a fund manager to, under certain conditions, be detached from a general partner, which means the fund manager does not have to concurrently act as the general partner of a QFLP fund.

11. **Removal of Additional Time limit for Fund Manager Registration and Fund Filing**

According to the 2017 QFLP Measures, a QFLP fund manager shall complete the AMAC registration and form the first QFLP fund or RMB PE or VC fund within 12 months after obtaining the approval of the QFLP business qualification, whereas all formed QFLP funds or RMB PE or VC funds shall duly complete filing with AMAC within 6 months after their establishment, failing any of which will result in cancellation of the QFLP pilot qualification and in public announcement thereof. The New Measures terminated the foregoing requirements and specifically provide that QFLP fund managers and QFLP funds will be legally compliant so long as they complete the AMAC registration or filing, as applicable, in accordance with the relevant provisions of the Tentative Measures for the Regulation of Private Investment Funds (私募投资基金监督管理暂行办法) and the Measures for the Registration of Private Investment Fund Managers and Record Filing of the Funds (Trial Implementation) (私募投资基金管理人登记和基金备案办法 (试行)).

12. **The End of a Number of Information Reporting Obligations**

The New Measures have terminated a significant number of old provisions relating to the obligations of QFLP fund managers, QFLP funds and custodian banks to report information to the Shenzhen QFLP authorities, and specified that QFLP fund managers, QFLP funds and custodian banks will be guided to access the Information Service Platform of Shenzhen Private Fund and to submit the enterprise data and relevant information through the information service platform. Under the New Measures, QFLP fund managers and QFLP funds, before changing their names, business scopes or shareholders/partners, increasing/decreasing subscribed/paid amount, or making other amendments, are no longer required to apply for and obtain any pre-approval from the Shenzhen QFLP authorities. This policy better streamlines and standardizes the information reporting process for QFLP fund managers, QFLP funds and custodian banks, and also enhances the overall efficiency of ongoing management, both laying a solid ground for future conversion of the pilot program to a regular one.

Since its inception in Shanghai in 2010, the QFLP pilot scheme has been evolving for more than a decade. At each important stage of the development of the QFLP pilot scheme (including the early stage around 2011/2012, middle stage around 2017/2018 and the current, relatively mature stage), Shenzhen has promptly issued or updated versions of the QFLP Measures, with each version closely matching the then-current regulations and practices of the foreign investment and private equity industry while also meeting diverse and dynamic local needs. Each version well reflects the consideration and focus of the Shenzhen QFLP authorities on the development of the QFLP pilot scheme at a particular stage. The improvement of the regulations also fits well with the process of continuously adapting regulatory measures to the QFLP practices in Shenzhen.

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