

Tianjin launched pilot programme for foreign-invested private equity investment

Tianjin is one of the pioneer cities in China to launch private equity (PE) investments to promote local development. In fact, the first officially approved RMB PE fund, Bohai Industrial Investment Fund, was born in Tianjin. Since Tianjin strengthened its scrutiny of the PE industry in July 2011 to combat fund-raising scams¹, it finally launched its own pilot programme (**Pilot Programme**) of foreign-invested PE fund (**FIE Fund**) on 14 October 2011.

An overview of the pilot programme

The *Interim Measures on the Tianjin Pilot Programme of Foreign-invested Private Equity Investment Enterprises and their Management Institutions* (**Interim Measures**) which took effect on the same day as the launch of the Pilot Programme, and its corresponding implementing rules (**Implementing Rules**) which took effect 30 days later, were jointly promulgated by four Tianjin government departments¹ to realise the Pilot Program. In accordance with the Pilot Programme, an FIE Fund or a foreign-invested equity management institution may, if qualified as a Pilot Enterprises or Approved Manager (as defined below) respectively, be exempted from foreign exchange control on equity investment. Reportedly, Tianjin has already secured US\$1 billion from the central foreign exchange regulator as the quota within which foreign currency of qualified foreign limited partners (QFLPs) will be allowed to be converted into RMB for PE investments in China. This Pilot Programme will therefore provide a new channel for foreign investors to inject capital into China's PE market.

The Interim Measures and the Implementing Rules (collectively **Tianjin Rules**) closely follow the legislative framework set out under similar pilot programmes implemented in Shanghai¹ and Beijing. For example, provisions on investment prohibition are almost identical, and the Shanghai and Tianjin Rules share the same eligibility requirements for QFLPs and the qualified senior management. The main features of the Pilot Programme are set out below.

Key Issues

An overview of the pilot programme	1
Eligibility requirements for Approved Managers and Pilot Enterprises	2
Foreign exchange settlement restriction	3
Comparison of rules among the three municipalities	3
Conclusion	4

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¹ Please see our Client Briefing "Tianjin Overhauls and Heightens Regulation for RMB PE Fund Industry", published in September 2011. [\[English\]](#) [\[Chinese\]](#)

² They are the Tianjin Municipal Commission of Development and Reform, the Tianjin Municipal People's Government Financial Affairs Office, the Tianjin Commission of Commerce and the Tianjin Municipal Administration for Industry and Commerce

³ Please see our Client Briefing "New Rules Extend Opportunities for Foreign Private Equity in Shanghai", published in January 2011. [\[English\]](#) [\[Chinese\]](#)

Eligibility requirements for Approved Managers and Pilot Enterprises

Tianjin Industrial Private Equity Investment Fund Development and Filing Administration Office (**Filing Office**) is the main organ that implements the Pilot Programme and reviews applications for recognition as a Pilot Enterprise or an Approved Manager. The Filing Office is coordinated by the Tianjin Development and Reform Commission and comprises other relevant Tianjin local authorities.

Approved Managers

In order for a foreign-invested equity management institution to qualify as an Approved Manager, it must satisfy the following requirements:

- (1) it must be incorporated and established in Tianjin;
- (2) its paid-in capital is no less than RMB10 million (or the equivalent in a foreign currency);
- (3) its business scope must be related to PE investment, such as (i) promoting and establishing PE funds, (ii) providing administrative services to enterprises in which such PE funds invest, (iii) managing assets on behalf of PE funds, and (iv) engaging in PE investment consultancy services;
- (4) it must have at least two senior management staff with the required experiences and credentials, and that most of the senior management team must be PRC citizens or PRC passport holders; and
- (5) it undertakes that the PE fund(s) it promotes or manages mainly invests in Tianjin's strategically emerging industries.

QFLPs

The foreign investor of an FIE Fund may be a QFLP if it satisfies the Filing Office that it has attained the following requirements:

- (1) in the last fiscal year before the application, its proprietary assets are no less than US\$500 million or that its assets under management are no less than US\$1 billion;
- (2) it has not been penalised by any judicial organ or regulator in the last two years;
- (3) it is a sovereign fund, pension fund, endowment fund, charity fund, fund of fund, insurance company, bank, securities company or other foreign institutional investor recognised by the Filing Office;
- (4) it contributes no less than US\$10 million to the FIE Fund; and
- (5) it or its affiliate has at least five years of relevant investment experience.

Pilot Enterprises

An FIE Fund sponsored by an Approved Manager and contributed by a QFLP may apply for Pilot Enterprise status. Capital contribution made to a Pilot Enterprise may be made by foreign investors in foreign exchange exclusively, or by PRC investors in RMB and foreign investors in foreign exchange. A Pilot Enterprise must have a fund size of at least RMB500 million (or the equivalent in a foreign currency), and the Approved Manager must contribute certain capital (no more than 5%) to the fund. Although the term "fund size" has not been defined under the Tianjin Rules, it generally refers to the aggregate amount of the paid-in capital and unpaid capital committed by investors in accordance with the *Circular on Further Regulation of the Development and Filing Administration of Equity Investment Enterprises in Pilot Regions*, issued by the General Office of the National Development and Reform Commission (**NDRC**). Under this Circular, a PE fund with a size of RMB500 million or more must be filed with the NDRC. Accordingly, every single Pilot Enterprise must be filed with the NDRC.

Foreign exchange settlement restriction

The prohibition on equity investment using funds converted from capital funds contributed by foreign investors has long been the main regulatory obstacle for foreign investors to penetrate into China's private equity market. Under a recent circular of the State Administration of Foreign Exchange on the administration of capital account transactions, this long-time prohibition has been further clarified.

Compared to other municipalities, Tianjin has, by far, issued the clearest rules on foreign exchange settlement of FIE Funds. The Tianjin Rules require each Pilot Enterprise and its Approved Manager that participate in the Pilot Programme to engage a qualified bank incorporated in Tianjin or a bank branch in Tianjin to take custody of its assets. Capital funds contributed by a QFLP in foreign currency must be remitted into a special capital fund account opened with the custodian bank, then converted into RMB within the approved quota on a project-by-project basis and finally credited into an investment account (where RMB contributed by Chinese investors, if any, would be collected in accordance with the agreed proportion) before the funds may be invested in the target companies. Since such an investment amounts to foreign investment and is regulated under the foreign direct investment regime⁴, the approval of the Ministry of Commerce (**MOFCOM**) or its competent local branch must still be obtained.

An Approved Manager may convert its foreign currency capital funds into RMB for investment of up to 5% of the paid-in capital of a PE fund which it sponsors. One important feature of the Pilot Programme is that where a PE fund in the form of a partnership is contributed solely by Chinese investors (and is therefore treated as a domestic-funded entity), capital contribution made by an Approved Manager alone would not alter the nature of the PE fund. Accordingly, investments made by such a PE fund will not be subject to industry restrictions under foreign direct investment rules or MOFCOM approval.

Comparison of rules among the three municipalities

The table below summarises some key features of pilot programmes for foreign-invested private equity investment in Shanghai, Beijing and Tianjin.

Issue	Shanghai Rules	Beijing Rules	Tianjin Rules
1. Pilot Area	Not specified. The Pilot Program will only be carried out in qualified districts on a gradual basis	Zhongguancun National Innovation Demonstration Zone (which covers a wide geographical scope)	Binhai New Area has been designated as the premiere venue to launch the Pilot Programme
2. Institutional Form Pilot Enterprise - Approved Manager -	Partnership Corporate or Partnership	Corporate or Partnership Corporate or Partnership	Corporate or Limited Partnership Corporate or Limited Partnership
3. Minimum Registered Capital of the Approved Manager	US\$2 million (20% paid within 3 month after issuance of business licence, the remainder to be paid within two years after issuance)	US\$2 million ⁵	RMB10 million (paid-in) ⁶
4. Business Scope of the Approved Manager	(i) Sponsoring and establishing PE funds; (ii) Managing the investment of PE funds	(i) Sponsoring and establishing PE funds; (ii) Managing the PE fund assets based on	Same as the Beijing Rules

⁴ Additionally, please note that under the Tianjin Rules, similar to the rules of Shanghai and Beijing, FIE Funds may not (i) trade shares, enterprise bonds and corporate bonds in the secondary market except for divestment transactions when it exits from the investee company, (ii) trade futures and other financial derivatives; (iii) invest in non-self-use real estate; (iv) invest by using non-self owned assets; and (v) provide loan or guarantee to others.

⁵ Under the relevant national laws and regulations, 15% of the registered capital of a foreign-invested enterprise must be contributed within three months after the issuance of its business licence, and the contribution of the remainder must be completed within two years after such issuance. If there is any specific requirement under the local rules, such requirements must further be complied with.

⁶ *Ibid.*

Issue	Shanghai Rules	Beijing Rules	Tianjin Rules
	based on entrustment and providing relevant services; (iii) Advisory business in relation to private equity investment; and (iv) Other relevant businesses that are permitted by the approval or registration authority.	entrustment; (iii) Providing administrative services to enterprises invested by the PE funds that it manages; (iv) Private equity investment consultancy; and (v) Other approved businesses related to private equity investment.	
5. Minimum Fund Size	US\$15 million (approximately RMB95 million)	RMB500 million	Same as the Beijing Rules
6. Minimum Capital Contribution by the QFLP	US\$1 million	Not specified	US\$10 million
7. Restriction of Foreign Contribution in the Fund	Not specified	No more than 50%	No restriction (may be contributed solely by foreign investors)
8. Contribution by the Approved Manager	No more than 5% of the subscribed amount	Same as the Shanghai Rules	Same as the Shanghai Rules
9. Investment focus	Not specified	An Approved Manager shall undertake that funds it sponsors or manages focus investment in seven strategic emerging industries in Beijing	An Approved Manager shall undertake that funds it sponsors or manages focus investment in strategic emerging industries in Tianjin
10. National Treatment of the Investment	Capital contribution by an Approved Manager will not affect the original nature of the PE fund	Not specified	Same as the Shanghai Rules
11. Custody of Funds	Required	Required (four types of custody accounts)	Same as the Beijing Rules
12. Profit Distribution	Not specified	Allowed after 3 years of the establishment of the Pilot PE Fund	Same as the Beijing Rules

Conclusion

Compared to other municipalities, although Tianjin started slightly late in attracting foreign PE investments and management expertise, the clearer legal framework and policy attitude towards QFLP it provides under the Pilot Programme should relegate it into a market well sought after by foreign PE firms.

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