Client Alert

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An overview of the QFLP pilot program and expectation

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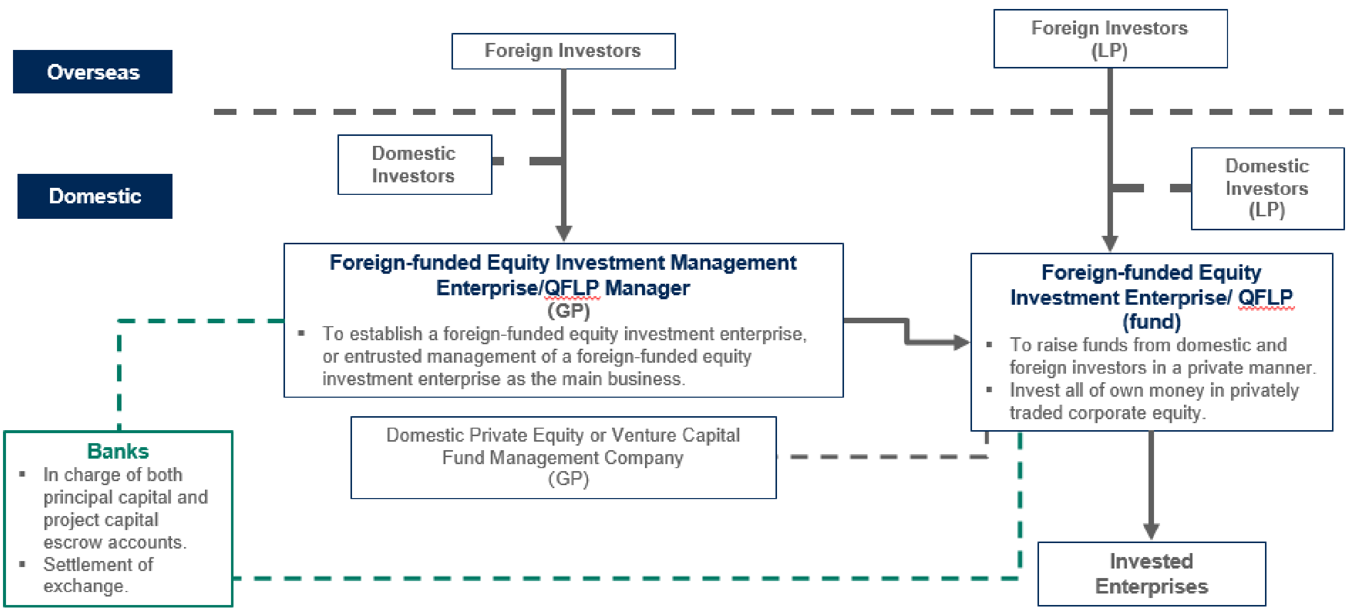
Overview

The Qualified Foreign Limited Partnership (QFLP) is a pilot program developed by various local authorities serving as an essential channel for foreign investors to invest in China's financial market. Under QFLP, foreign investors are able to participate in the establishment of a foreign-funded equity investment management enterprise (QFLP Manager) or a foreign-funded equity investment enterprise (QFLP Fund) (QFLP Manager and QFLP Fund are collectively referred to as QFLP Enterprises). The most obvious advantage of QFLP is that foreign exchange funds can be settled in RMB at the fund level and make equity investment in RMB, in other words, foreign exchange settlement will be approved in advance at the time when a QFLP enterprise is set up, instead of when the capital is called.

QFLP was firstly introduced in 2010 in Shanghai and then consecutively available in Beijing, Chongqing, Tianjin, Shenzhen, Qingdao, Guizhou, Pingtan, Zhuhai, Guangzhou, Xiamen, Suzhou, Hainan, Nanning, Xiong'an, Nanjing and thereafter more cities or regions. Based on the different development history and practical needs of cross-border investment, the approaches to QFLP across different cities or regions have their own characteristics. Under this background, how to select the appropriate QFLP pilot shall be the primary issue for foreign investors.

Basic structure of QFLP



** The investors' eligibility, investment scope and the period of approval procedures can be various in different cities.*

QFLP Managers are mainly engaged in initiating the establishment of QFLP Funds or entrusted management of QFLP Funds. A QFLP Manager generally acts as the general partner of the QFLP Fund. In the early QFLP policy of some regions, the QFLP

Manager was generally required to be wholly foreign-funded or a Sino foreign joint venture, and the limited partner should be a foreign investor. With the successive introduction and development of local QFLP policies, many pilots started to allow qualified Domestic Private Equity or Venture Capital Fund Management Companies to initiate the establishment of QFLP Funds and allow domestic investors to participate in the QFLP Fund as the limited partner as well. In addition, QFLP policies in most regions also specifically require QFLP Enterprises to entrust qualified commercial banks to manage project funds.

Major restrictions on the investment and establishment of QFLP Enterprises by foreign investors under the overseas law

Foreign investors who participate in the investment and establishment of domestic QFLP Enterprises shall also pay special attention to the restrictions of overseas laws and regulations and remain subject to specific industry rules. Based on our experience, although some countries or regions don't have general restrictions preventing relevant entities' investment in funds of other countries, where these entities belong to a specific industry, they nevertheless also need to factor in and continue to comply with any applicable special domestic industry rules. If, for example, we consider entities in Hong Kong, Hong Kong laws may not impose generally applicable restrictions on Hong Kong entities' investment in QFLP Enterprises of the Mainland. However, if the entity is an insurance company, it is normally regulated by the Insurance Authority and subject to the provisions of the *Insurance Ordinance of Hong Kong* and other rules, guidelines and regulations of the insurance industry, as well as the notices and announcements formulated or issued by the Insurance Authority from time to time. More specifically, they shall not violate the requirements of the applicable capital adequacy ratio and solvency limit, and shall fully comply with not only the minimum governance standards in corporate governance proposed in the *Guideline on the Corporate Governance of Authorized Insurers* issued by the Insurance Authority, but also any terms agreed by themselves under their business operations. These special requirements may singularly or collectively have the effect of limiting the capacity of certain foreign entities to invest in a QFLP Enterprise.

Key elements of QFLP

- Supervision system

1.	Competent department to grant the approval	Most regions such as Beijing, Shanghai and Shenzhen establish a joint review mechanism involving all competent departments to review and grant the qualification of QFLP Enterprise with the local financial regulatory bureau generally being designated as the main contact department. In a few regions including Hainan and Guangzhou, instead of implementing a specified joint review mechanism, the qualification process only stipulates that the relevant departments are responsible according to the division of their responsibilities.
2.	Registration/filing requirements in AMAC	Except for some early regions like Shanghai and Tianjin which promulgated their QFLP policies before the establishment of the Asset Management Association of China (AMAC), almost all pilot areas require their QFLP Enterprises to be registered or filed with AMAC. We understand that this shall be a necessary step for the QFLP Enterprise application procedures going forward and it should be noted that QFLP Managers will be forbidden to initiate any QFLP Funds without AMAC registration/filing and QFLP qualification of any existing QFLP Fund they first initiated might also be cancelled if there has not been compliance with the AMAC registration/filing requirements.
3.	Information submission	Most local QFLP policies also have distinct requirements for QFLP Enterprises to submit information to the supervisory departments regularly or perform the report obligations according to the regulations and self-discipline rules of private equity. For instances, QFLP Enterprises in Beijing are asked to provide business report, fund custody report regarding custodian banks, annual financial report and quarterly major event reports to the joint review office. In contrast, QFLP Enterprises in Hainan need to report major events including operation report and revision of important legal documents to Hainan Financial Regulatory bureau every six months, and Shenzhen QFLP Enterprises shall access to the private equity fund information service platform.

- QFLP Manager

1.	Registration	A QFLP Manager generally can be organized in the form of a company or partnership and shall register in the pilot regions. A QFLP Manager is allowed to be wholly foreign-owned, a Sino foreign joint venture or wholly domestic in most pilots.
2.	Capital contribution	Generally, RMB or other freely convertible foreign currencies can be used as a subscribed capital contribution. Most QFLP pilots such as Guangzhou, Beijing and Hainan, do not impose specific restrictions on the proportion of initial capital contribution, the proportion of monetary capital

		contribution, and the period of capital contribution, while some regions such as Shenzhen require the establishment of QFLP Managers to be in line with the requirements of foreign-funded enterprises and private equity. In addition, it is noteworthy that the *Instructions for the Registration of Private Fund Managers (updated in December 2018)*[1] formulated by AMAC requires that the paid in capital / paid in capital of private fund managers should be sufficient to cover daily operating expenses such as reasonable labour remuneration and rental for a period of time. Meanwhile, due diligence (including a legal memo) conducted by a law firm is also required on the capital and capital conditions of the manager. Furthermore, if the paid in capital of the fund manager is less than 25% of the registered capital / subscribed capital, such situation will be specially publicized by AMAC.
3.	Threshold of investors	The threshold requirements vary from place to place. For example, Beijing requires the manager shareholders, actual controllers and executive partners to be financial enterprises or foreign currency fund management enterprises with a management fund scale of not less than RMB 100 million yuan or equivalent foreign currency. However, there are also regions that do not specifically set the threshold in their QFLP policies, such as Hainan and Guangzhou. Therefore, the investors are advised to consult the local competent authorities on a case by case basis before going through the process of actual application.
4.	Senior management	With regard to the definition of the scope of senior management, there are differences in the QFLP policies of different regions, but they also have some similarities, including requiring a certain number of senior managers who have corresponding work experience in the private equity investment sector. Furthermore, in addition to considering the QFLP policies, it is also necessary to pay attention to the requirements of relevant rules for private fund managers.

- QFLP Fund

1.	Registration	A QFLP Fund can be organized in the form of a company or a partnership and must register in the pilot regions in general.
2.	Capital contribution	At present, there are different policies and regulations on the amount and duration of QFLP funds in each of the different pilot areas. Except for some regions that specify the fund size requirements, (for example, Beijing requires that in principle each fund shall not be less than RMB 100 million yuan or the equivalent amount in foreign currency), more and more regions such as Guangzhou and Hainan have adopted the "zero threshold" approach which does not establish any minimum threshold requirement for capital.
3.	Threshold of investors	The threshold requirements for investors of QFLP Funds vary from place to place. For example, Beijing puts forward specific requirements for foreign investors' investment experience, internal control system and asset amount, while Zhuhai puts forward preferential policies for Hong Kong and Macao investors, such as lowering the threshold for a subscribed capital contribution. In addition, most pilots do not specify requirements for domestic investors, and even some pilots such as Shenzhen, Guangzhou and Hainan seem not to set specific thresholds for either foreign or domestic investors in their QFLP policies, so the investors are suggested to consult with local authorities for more detailed information in advance.
4.	Investment scope	The QFLP policies of various regions are regulated by reference to permitted and prohibited matters (mainly referring to the Negative List). In addition to being excluded from investing in prohibited areas for foreign investment, QFLP funds are also not allowed to be directly or indirectly used for securities investment (secondary market investment) and non-self-use real estate (real estate fund investment) according to the *Notice of the State Administration of foreign exchange on reforming the management method of foreign exchange capital settlement of foreign invested enterprises*[2]. In addition, many regions have made it clear that they can carry out investment in qualified listed companies, such as Beijing and Shenzhen, which permit that the investors can engage in non-public equity, non-public issuance and trading of common shares of listed companies.

- Other focused matters

1.	Custodian bank	Almost all the QFLP policies require QFLP Enterprises to entrust a commercial bank with fund custody capacity and associated qualification to manage the capital, including reviewing compliance with any restrictions on the use of capital, supervising the use of capital to ensure it is within the business scope, performing the AML and CFT obligation and urging the QFLP Enterprises to settle all the taxes when entering the liquidation procedure. Some regions such as Hainan and Beijing also specify that the custodian bank shall have local branches and satisfy above level 2 branch I requirements (inclusive of

[1] 私募基金管理人登记须知（2018 年 12 月更新）Refer to https://www.amac.org.cn/businessservices_2025/privatefundbusiness/registrationandfiling/bszn/202206/t20220629_13896.html

[2] 《国家外汇管理局关于改革外商投资企业外汇资本金结汇管理方式的通知》Refer to http://m.safe.gov.cn/safe/2015/0408/5549.html

		level 2 branch), while some regions such as Shenzhen only require that custody shall be handled in accordance with relevant AMAC rules.
2.	Tax policy	Most regions such as Shanghai and Shenzhen have no specific regulations on tax; while a few regions such as Guangzhou specify detailed provisions and give some preferential tax policies. It is suggested to further consult with the local competent authority and confirm their policy position regarding tax.
3.	Withdrawal of investors and capital remittance	From the perspective of current QFLP policies of most pilot areas, there are basically no obstacles for the withdrawal of foreign investors and cross-border remittance of relevant capital. Many regions provide that the investors can withdraw from QFLP Enterprises by means of equity transfer, capital reduction, and liquidation stipulated in the laws and regulations or agreed in the investment agreements. The remittance of funds will still need to conform to the regulations of SAFE and relevant QFLP Enterprises are required to complete tax payment responsibilities including submitting relevant tax payment certificates to the custodian banks for a review and approval.
4.	Supportive policy	Different regions may adopt various preferential or supportive approaches in their QFLP polices to attract investors, such as seen in Guangzhou, Hainan and Nanning. These policies may generally include tax incentives for enterprises like incentives for establishment, subsidies for office buildings, and welfare treatment incentives for talents including relocating for employment, buying cars and houses, children's enrolment, medical, housing security, etc. Investors can make specific consideration on these policies before selecting the final landing place.

Tips

In conclusion, the QFLP policies in various regions have both similarities and differences. Therefore, we remind investors to pay special attention to the following issues in the early stage of establishing QFLP Enterprises:

- **Choose the right investment district.** QFLP policies implemented in different regions are not the same, so the requirements for investors' access qualification, the application process and final landing time of QFLP Enterprises are also distinct. The most appropriate investment area should be selected from the outset according to the specific circumstances of the project.
- **Identify the competent department and communicate in advance.** The investors must strictly follow the Negative List, and timely communicate with the regulatory authorities when seeking to clarify any unclear or uncertain investment areas. While communicating with the supervision departments, the applicants may possibly be asked to sign relevant confidentiality agreements in advance so as to obtain relevant application forms. The actual time of this process is difficult to estimate.
- **Focus on practical requirements.** Investors must not only pay attention to the restrictive content of any written policy, but also to the requirements of the local regulatory authorities at the specific operation level, and sometimes investors may need to refer to the relevant provisions of the QFLP policies in other regions. For example, the practice of Shanghai QFLP has already departed from its original written policy in many aspects to the extent that it has not only largely eliminated the policy differences with other regions, but also formed comparative advantages in terms of application conditions, investment scope and government services.

Furthermore, it is not difficult to find that with the increasing development of the investment environment, QFLP policies in various regions are also constantly adjusted and optimized - from the initial specific provisions and control provisions to the gradual relaxation and even the gradual convergence of domestic and foreign capital management. This trend is bound to attract more investors to focus on the investment policies of the QFLP pilot areas in China and actively participate in and promote the completion of the projects on the ground thereby further promoting the introduction of funds and economic development in these specific areas and achieving mutual benefit and win-win results.

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