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A legal update from Dechert's Private Equity Group

# Pudong Takes the Lead in Permitting Foreign Private Equity Investment Management Companies to Open Shop in Shanghai

Following swiftly on the heels of Shanghai's announced intention to open its doors to foreign private equity and growth capital firms, the Pudong New District of Shanghai has released provisional rules permitting foreign private equity investment management companies to form subsidiaries or Sino-foreign joint ventures. The rules represent a significant step toward the liberalization promised to private equity and growth capital firms. *See* June 2009 *Dechert OnPoint* "Shanghai to Permit Foreign Private Equity and Growth Capital Firms to Open Shop".

As was the case with earlier rules covering foreign banking operations, these new investment management firms are permitted only in the Pudong New District of Shanghai. Three governmental bodies are charged with approval, registration and oversight responsibilities. These are the Pudong New District Economic Commission (functionally the local arm of the Ministry of Commerce, which approves all foreign investments), the Shanghai Financial Services Office and the Pudong New District Administration of Industry and Commerce. Approval, registration and oversight of these new entities will follow the rules and regulations generally applicable to foreign investments.

Specific requirements for any investment management company include minimum equity capital of at least US$2.0 million. Twenty percent of the capital, or US$400,000, must be paid in within three months after the company's business license is issued, and the balance of US$1.6 million must be fully paid in within two years. At least one investor, or an affiliate of the investor, must be in the investment or investment management business. In addition, senior management of the company must include at least two officers with two or more years of relevant industry experience, and at least two years in senior management positions. The rules also make it clear that if they meet these requirements, existing foreign-owned subsidiaries or joint ventures will be allowed to convert their status to investment management companies.

An investment management company set up under these new rules will be authorized to manage investments and provide related consultancy services. The Financial Services Office indicated that these companies may manage investments for their offshore funds. They have also indicated that, once the law permits, these management companies will be allowed to manage their own domestic RMB funds.

The rules make it clear that the incentives for foreign financial institutions in Pudong will cover these management companies. The incentives include assistance with office costs and rental, and tax refunds of up to forty percent for senior personnel and up to twenty percent for key management. These benefits distinguish the new management company vehicle from the ordinary consulting company or representative office, neither of which is entitled to these incentives in Pudong (or elsewhere in Shanghai).

Notably absent from the provisional rules is any mention of partnership structures and direct ownership of an investment company by an offshore fund. Features of this sort will likely require national rulemaking, and the agreement of the foreign exchange control authorities.

The provisional rules, unlike many provisional rules which have been on the books for years or

decades, by their terms will be in force only through June 2010. We believe this short "shelf life" indicates more regulatory advances are in the pipeline. Those wishing to get their foot in the door should act quickly to take advantage of the new rules in Pudong so that they will have an entity in place, on the ground and ready to take advantage of further liberalizations in this area.

## Practice group contacts

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