

Impact of China's New Foreign Exchange Rules on Structuring of Private Equity Investments

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PE Investor

Offshore

China

Other shareholders

Local Gov't Co.

Mr. CEO

16.7%

33.3%

50%

Domestic Co.

Onshore Model

Disadvantages of Onshore Model:

- No preferred or convertible shares
- Agmts may not be governed by non-PRC law; amendments need PRC government approval
- Government approvals for exit (IPO, trade sale)
- Chinese partners' statutory veto rights
- Tax disadvantages for sellers

Offshore



China



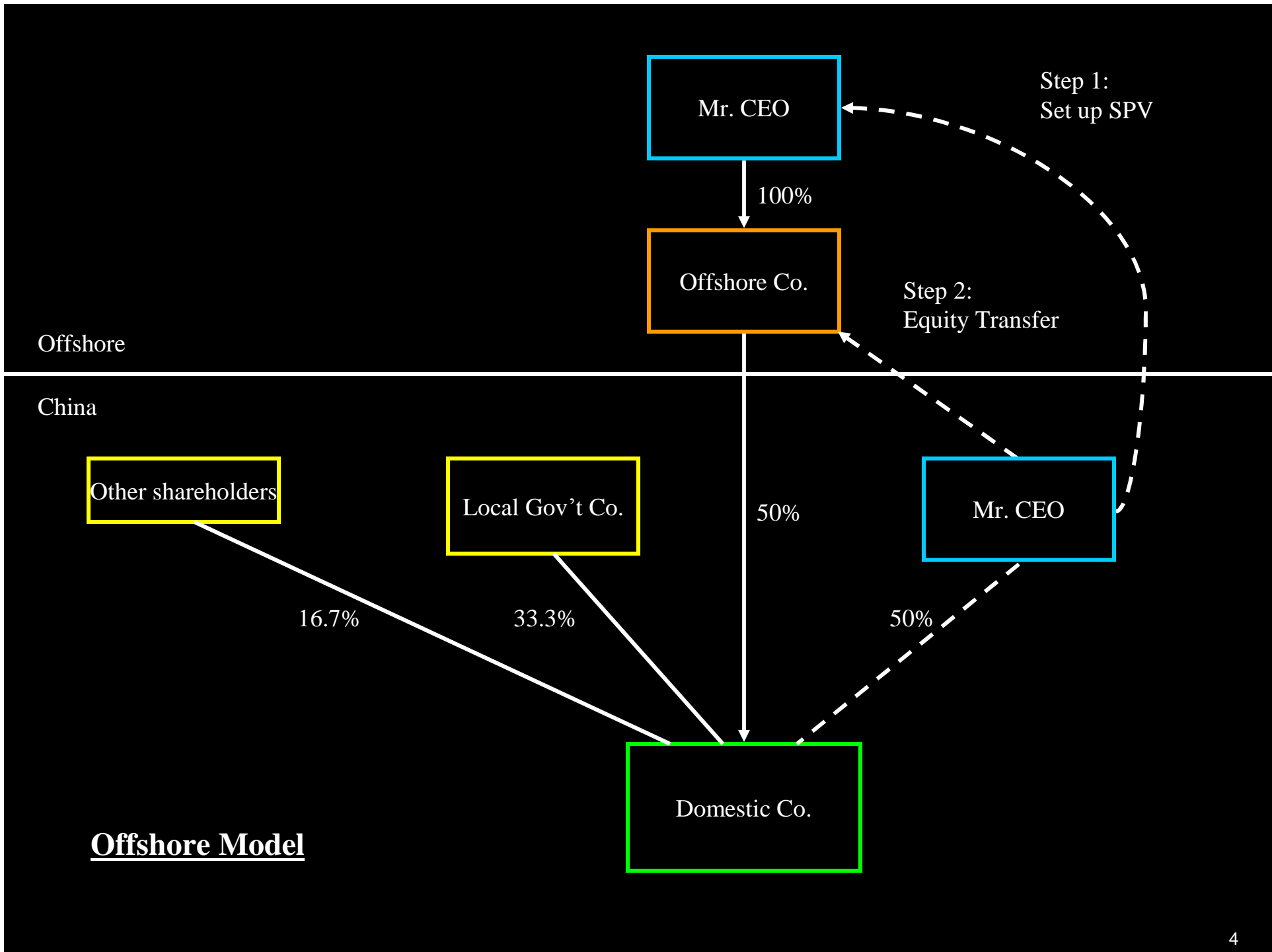
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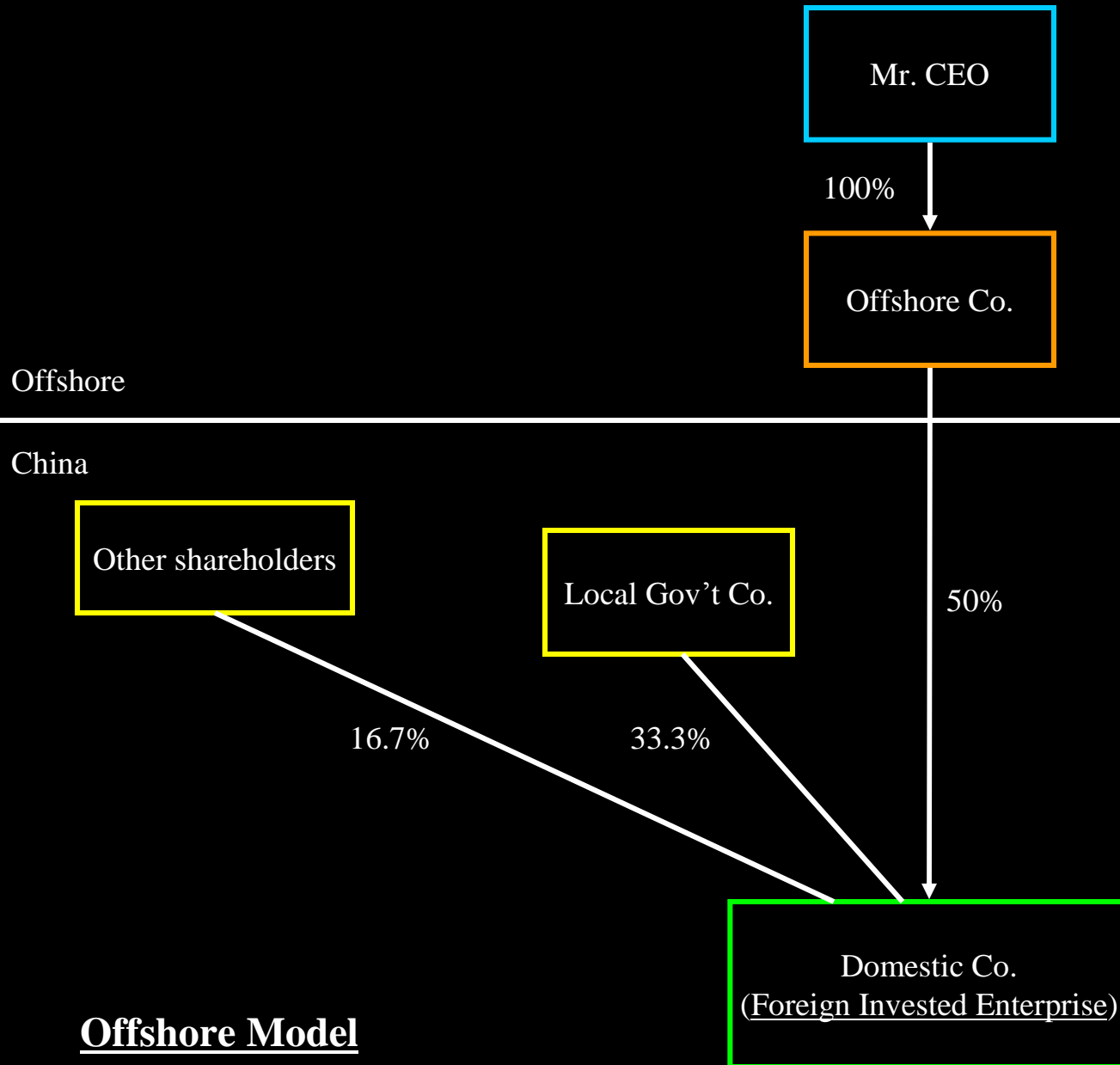
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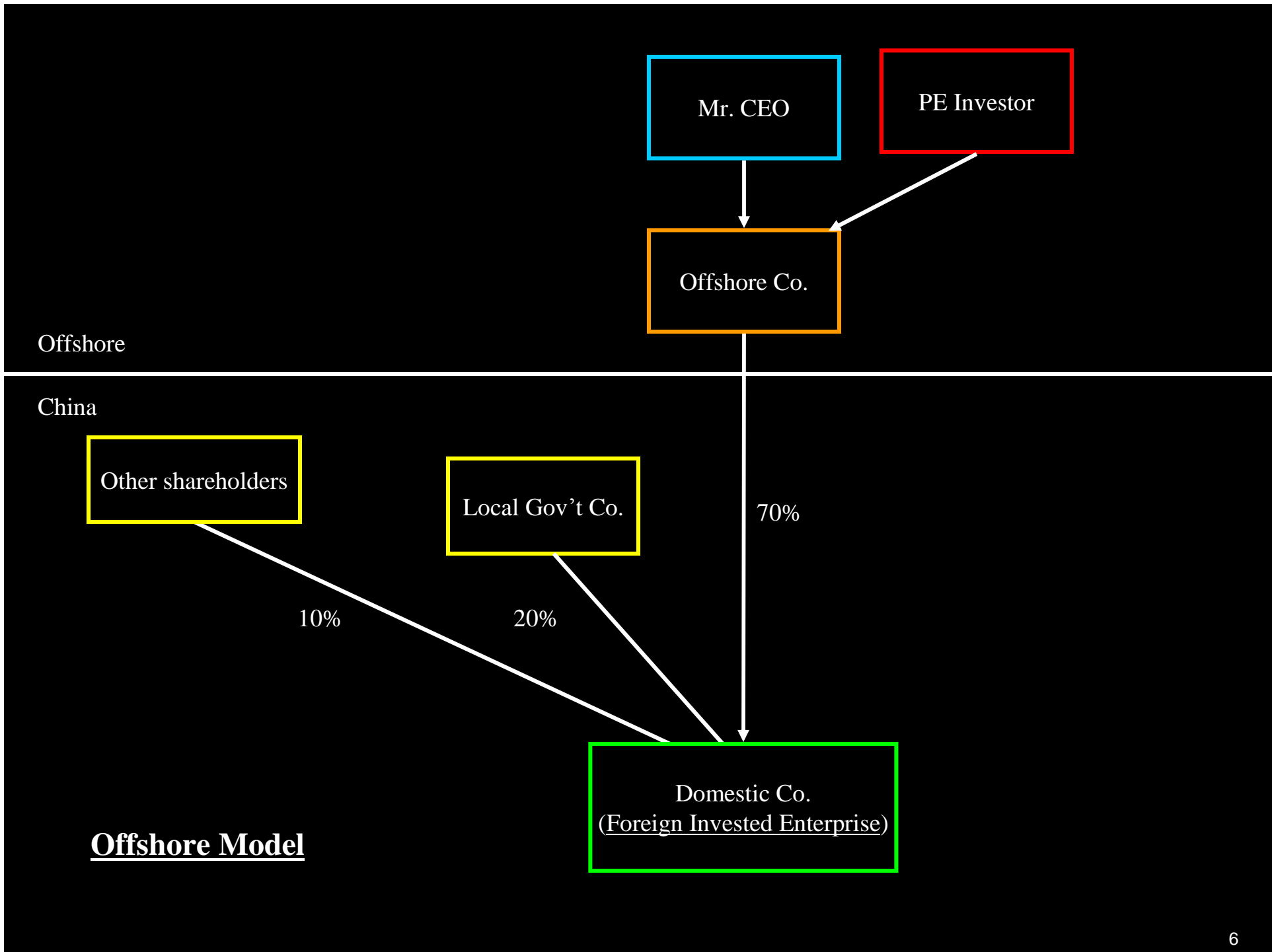
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Onshore Model



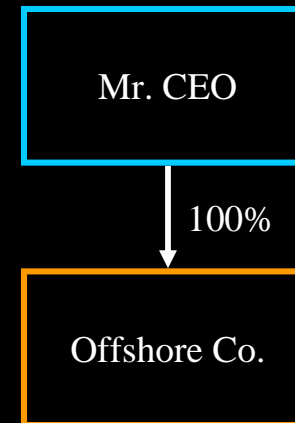




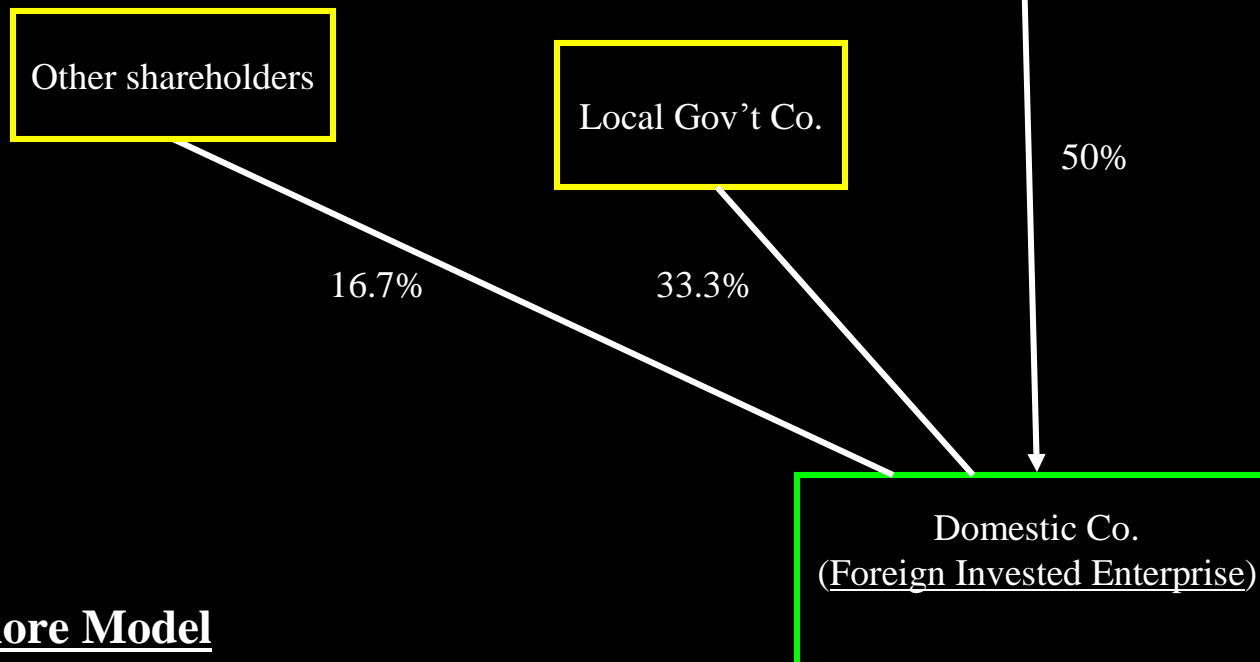
Under Old SAFE Circulars 11 & 29:

- Before Step 1, (i) MOFCOM approval; (ii) SAFE approval for overseas investmt forex registrn certificate
- Before Step 2, SAFE approval to amend forex registratrtn
- Disclose ultimate controlling persons and track record (central SAFE approval if same management)
- All forex proceeds of financing, dividend payments or other distributions to shareholders remitted back to China within 30 days of receipt (cannot comply w/i (i))

Offshore



China

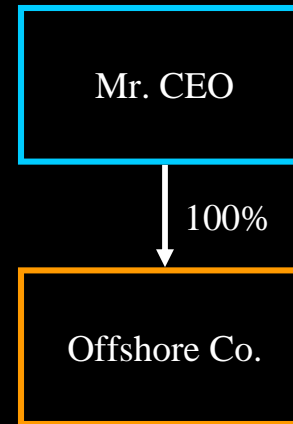


Offshore Model

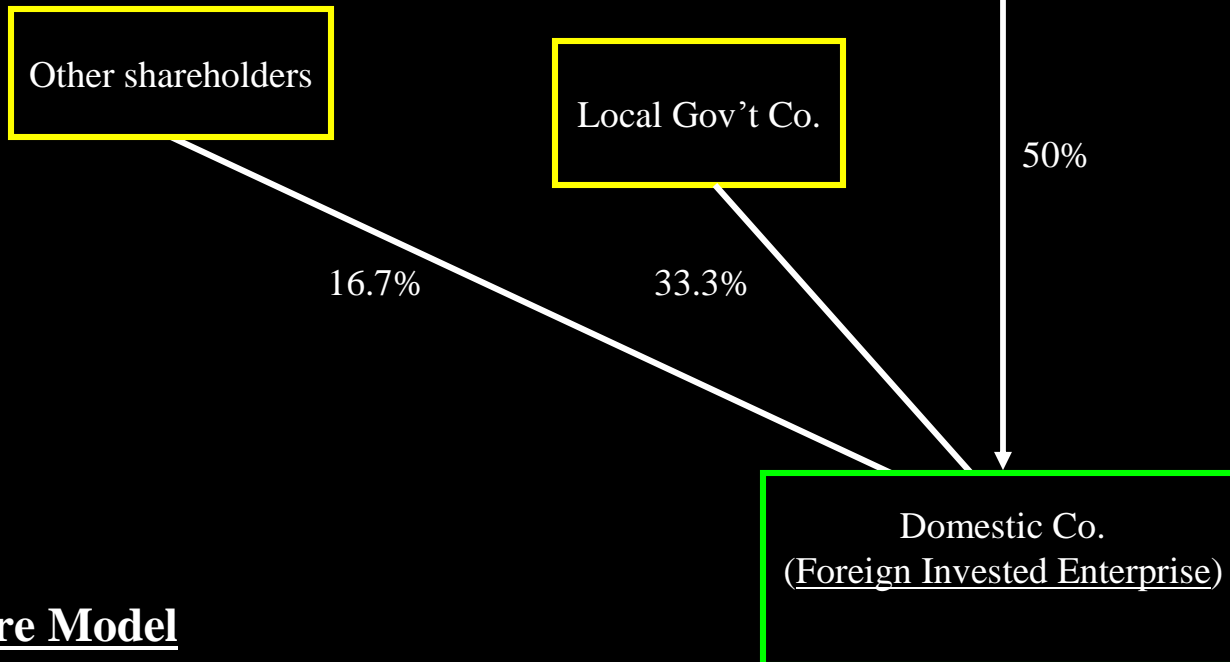
Under New SAFE Circular:

- Still overseas investmt forex registn certificate, but no MOFCOM approval, SAFE registration before Step 1 vs. approval.
- No disclosure of ultimate controlling persons / track record
- Proceeds of financing to be used pursuant to financing plan
- Remit dividends or other distributions to China within 180 days vs. 30 days previously

Offshore



China



Offshore Model

Ongoing Reporting Obligations of Chinese Shareholders

- File reports with SAFE within 30 days of:
 - Increase or decrease of capital of Offshore Co.
 - transfer or swap of equity interest in Offshore Co.
 - when Offshore Co. engages in any consolidation or split
 - when Offshore Co. makes any long-term equity or debt-investment or provides any guarantees
 - other material events that affect capital structure of Offshore Co.

- Potential pitfall for PE investor

Looking Ahead ...

- Positive development; further clarification expected
- Observations:
 - Chinese regulators inexperienced in dealing and new financing techniques of capital markets
 - But keen to improve and become more receptive
 - Role of educating Chinese regulators and developing the PE market