Alerts & Publications

CIRC Unleashes Insurance Capital for Private Equity Investments Offshore

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In a significant development for the global private equity industry, a brand new source of capital has been opened up for private equity fund sponsors raising institutional capital, with the promulgation of new rules by the China Insurance Regulatory Commission ("**CIRC**") which permit Chinese insurance companies to make commitments to international private equity funds for the first time. These new rules, the *Implementing Rules of the Provisional Measures on Outbound Investments with Insurance Capital* (the "**Implementing Rules**") which were announced on October 12, 2012, also permit investments by Chinese insurers into other international asset classes, such as fixed income products, equity type products, money market products, securities investment funds and real estate in 45 countries and regions. The Implementing Rules will create a slate of large qualified Chinese institutional investors for the international private equity fund market, which is expected to be a significant boost to the scarce Chinese institutional limited partner base currently available to offshore private equity funds, as currently only a few institutions such as China Development Bank, China Investment Corporation and the State Foreign Exchange Administration are permitted to invest in offshore private equity funds.

As explained in a previous client alert[1], a little over two years ago, and to great fanfare, CIRC granted permission for Chinese insurance companies to make investments into equity, including through private equity funds, via the *Provisional Measure on Equity Investments with Insurance Capital* (the "**Provisional Measures**"). At the time, the rules were fairly restrictive in their scope, and only explicitly provided for requirements concerning onshore Chinese investments, whether direct investments into onshore companies or via onshore (reniminbi) private equity funds, while outbound investments were left for other regulations. Indeed, anecdotally, it is believed that Chinese insurers have made only very limited use of this permission with only a few investments being made.

The Implementing Rules contain a number of qualifications which will need to be met in order for a private equity fund to be eligible for Chinese insurance money. These include:

- the institution that sponsors and manages the private equity fund must have actual paid-in capital or net assets of at least US$15 million;
- the institution that sponsors and manages the private equity fund must have cumulatively managed assets of not less than US$1 billion;
- the private equity fund must have committed capital of not less than US$300 million and a portion of its commitments must have been contributed (it is not clear how much capital will be required to have been paid in to be approved and this will be subject to interpretation by CIRC);

- certain requirements as to investment team composition, track record, corporate governance, incentive and control mechanisms, and key person provisions, must be met;
- the private equity fund must target growth or mature companies or companies which have potential for mergers and acquisitions, to which the geographic restriction of the 45 regions and countries do not apply (we would note that the rules explicitly provide that the investments of the other types of investment funds should be made within the specified 45 regions and countries and such other types of investment funds must be recognized by the relevant securities regulatory authorities or registered in such countries or regions). Funds of funds are generally also eligible for investments;
- in the Provisional Measures which regulate onshore equity investments, venture capital funds were explicitly excluded from the list of permitted investments due to the perception of higher risks involved in such funds by the regulators; interestingly, the Implementing Rules are silent in this regard and we believe that venture capital funds targeting more mature, revenue generating companies may well be eligible if other requirements are met;
- in what may be regarded as a homage to the Volcker rule[2] restricting investments by U.S. investors into funds managed by banks, a private equity fund that is controlled by or whose general partner is or is held by a financial institution or its subsidiaries would not be eligible. Under Chinese laws and regulations, financial institutions are very broadly defined to include commercial banks, trust companies, securities companies, securities investment fund management companies, insurance companies, financial holding companies, etc[3]. This requirement may render private equity funds sponsored by institutions that fall within the definition of financial institutions ineligible for investments by insurance companies, although it remains to be seen how CIRC will interpret this.

We would note the Implementing Rules refer to the "institution that sponsors and manages the fund" in terms of certain of the net assets/capitalization requirements described above. Given that many fund sponsors divide their management function between a general partner and an investment manager/advisor, it is unclear at this stage whether CIRC would count the assets of other group companies towards such requirements. Careful consideration of this issue and how the fund should be structured will be necessary.

In addition to meeting such requirements, we would expect that CIRC approval would be expressly required for any individual commitment to be made to a private equity fund, as has been the case with respect to investments into renminbi funds to date. The experience of a number of our clients who have been raising capital from Chinese insurers for their renminbi funds is that this has been a very time consuming and lengthy process.

The Implementing Rules represent CIRC's continuous effort to further relax the regulation of equity investments by insurance companies. In addition to the Provisional Measures described above, in July 2012, CIRC issued the *Notice on Relevant Issues Concerning Equity Investments and Real Estate Investments with Insurance Capital* (the "**Notice**"), to clarify and supplement the Provisional Measures. The Notice removed the requirement that an insurance company must have made a profit in the preceding year in order to make equity investments and lowered the net assets requirement for insurance company from RMB1 billion to RMB100 million and solvency ratio requirement from 150% to 120%. The Notice also increased the amount of insurance capital that can be used for direct and indirect equity investments (for both onshore and offshore in aggregate), from 5% to 10%, of the total assets of an insurance company as of the end of the preceding quarter. Given the RMB6.7 trillion balance of assets of Chinese insurance companies as of June 2012[4], it is estimated that a maximum of approximately RMB670 billion (equivalent to US$106 billion) will be available for investments into onshore and offshore private equity funds. We will closely monitor any further developments in this regard, especially how CIRC will interpret certain issues that remain to be clarified.

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[1] Click here for a copy of the previous client alert.

[2] Click here for a copy of a client alert on the Volcker rule.

[3] Click here to see for example, Standard Code of Financial Institutions.

[4] Source of data: http://www.circ.gov.cn/web/site0/tab454/i209393.htm.