



New SAFE rules on domestic individuals' participation in share-based incentive plans of overseas listed companies

Regulation discussed in this issue:

- Circular 7 was issued by PRC State Administration of Foreign Exchange ("SAFE") on 20 February 2012 to replace Circular 78 (issued in 2007), to simplify the process for SAFE registration of share-based incentive plans.

Background

On 20 February 2012, the State Administration of Foreign Exchange ("SAFE") issued Hui Fa [2012] No. 7 ("Circular 7") to replace Hui Zong Fa [2007] No. 78 ("Circular 78") and Hui Zong Fa [2008] No. 2 ("Circular 2"). Issuance of Circular 7 clarifies the procedural requirements on SAFE registration of share-based incentive plans previously stipulated by Circular 78 from a practical perspective, whilst extending coverage of the application of the registration requirements and putting in additional measures for timely on-going monitoring.

Enhanced clarity on procedural requirements

Under Circular 7, apart from introducing a formal application form (although a simplified version of the form has been used in practice since Circular 78 was implemented), the amount of required documentation has been reduced to:

1. Application letter
2. Public notice issued by the listed company that proves the authenticity of the equity-based incentive plan(s)
3. Letter(s) / agreement(s) appointing the main applicant / local agent in China for the registration procedures
4. Proof issued by the participating entities in China of the employment or labour service relationship between the entity and the individuals, including personal details of the individuals and the type of share-based incentive awards given
5. Other documents to prove the authenticity of the relevant transactions as required by local SAFE branch

Extension of coverage

Circular 7 extends the application scope of the SAFE registration requirements in the following aspects:

- *The types of entity* include PRC companies and parent and subsidiaries of the foreign-listed companies; Branch offices (including representative offices) of the foreign-listed companies; PRC organisations (including parents, subsidiaries or joint ventures) controlled by the foreign-listed companies
- *The types of individuals* who are covered include directors, supervisors, senior management, other employees or those who have an employment or labour service relationship with the relevant entities outlined above and are entitled to participate in the share-based incentive plans; and who are of Chinese nationality (including residents of Hong Kong SAR, Macau SAR and Taiwan) and foreigners who are residents of China.
- *The types of plan* include Employee Ownership Plans, Stock Option Plans, Share Appreciation Rights Plans, Restricted Stock Units Plans, Performance Share Units Plans, Phantom Shares Plans and Employee Share Purchase Plans, plus a catch-all category for “other” plans.

Monitoring and enforcement

The new circular strengthens enforcement of the registration requirement with increased monitoring by:

- Requiring the main applicant/local agent to adhere to the following within **three** working days following the end of each quarter:
 - on-record filing to report the status of the equity-based compensation plans
 - report major changes in the share-based incentive plans, including changes to the main applicant or its designated agent, as well as changes to the operation of the plan

De-registration formalities in the event the plan expires, termination of the plan due to delisting of the foreign listed company, or restructuring and merger of the PRC entities, should be completed within **20** working days following termination of the plan.

- Imposing additional reporting requirements on the banks with which the designated foreign currency accounts are set up (“the designated banks”) to:
 - report each month’s foreign exchange transactions;
 - track and report the opening and closure of these foreign currency accounts

within **three** working days following the end of each month.

- Requiring individuals who use their own foreign currency reserves in the share-based incentive plans to register such usage
- Requesting details formally for the company’s policy on the treatment of awards held by terminated participants

KPMG observations

Although Circular 7 appears to have reduced the amount of details required for SAFE registration, the extended application of SAFE registration and provisions on the subsequent reporting requirements no doubt reflect the authorities' intention of closing loopholes under the old provisions and implementing additional measures to monitor the conversion of foreign exchange for participation in share-based incentive plans.

Foreign listed companies which currently or intend to grant share based awards to employees of their Chinese subsidiaries, branches, representative offices or joint ventures should review:

- the types of share-based awards (whether the awards will be delivered in cash or shares) on offer that could be subject to new SAFE registration requirements, and submit a new application for registration of all the relevant plans or apply to register additional plans which were not included in the original registration performed under Circular 78;
- the population of individuals who would be subject to the SAFE registration requirement and accordingly register foreign nationals and residents of Hong Kong SAR, Macau SAR and Taiwan.
- the existing internal reporting mechanism to ensure that they can comply with the reporting requirements stipulated in Circular 7 following the set-up of the designated foreign currency account on a timely basis.

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