

Corporate

# China Bulletin

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- New SAFE Rule on Onshore Individuals' Shareholding in Offshore Listed Companies



Welcome to White & Case's monthly China Corporate Bulletin. This bulletin covers recent corporate regulatory developments and news in the PRC and Hong Kong, ensuring you stay up to date on the latest market issues.

### New SAFE Rule on Onshore Individuals' Shareholding in Offshore Listed Companies

The State Administration of Foreign Exchange ("**SAFE**") recently promulgated a new rule regarding SAFE registration of onshore individuals' shareholding in offshore listed companies, the *Circular of the State Administration of Foreign Exchange on Issues Concerning the Administration of Foreign Exchange Used for Onshore Individuals' Participation in Equity Incentive Plans of Companies Listed Offshore* (Huifa [2012] No.7) ("**Circular 7**"). Effective on February 15, 2012, Circular 7 supersedes the previous governing rule on the same subject, *Operation Rules on the Foreign Exchange Administration of the Participation of Onshore Individuals in Offshore Listed Companies' Employee Shareholding Plans and Share Option Plans* (Huizongfa [2007] No.78) ("**Circular 78**") in its entirety.

In general, Chinese individuals' investments in overseas stock markets are restricted. Under Circular 78, an overseas listed company is allowed to grant certain types of equity-based compensation to employees of its PRC affiliates under the company's stock incentive and employee stock plans, provided that such grant is registered with SAFE. Circular 7 keeps this registration requirement while introducing the following notable changes.

#### Focus of control changes from foreign exchange to the stock plan itself

Under Circular 78, SAFE's role is to control the conversion and payment of foreign exchange for individuals' participation of stock plans. Circular 7 launches a new registration scheme making the stock plan itself the focus of SAFE control. Accordingly, the application process for conversion and payment of foreign exchange is significantly simplified. SAFE will now issue a specific foreign exchange registration certificate upon its approval of the stock plan.

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Also, applicants are required to amend their prior registration with SAFE in case of material changes to the stock plan (e.g. amendment to key provisions, adoption of new plans or change as the result of a merger, acquisition, or reorganization) within three months and de-register the registration within 20 working days in the event of termination of the stock plan.

### Scope of Application Expanded

Equity-based compensation plans that are subject to registration under Circular 78 include employee stock plans and option plans. Although the main text of Circular 7 only generally refers to “equity incentive plan,” one of its attachments lists the following types of awards: employee stock plans, stock options, stock appreciation rights, restricted stocks/restricted stock units, performance stocks/performance stock units, phantom stock, employee equity purchase plans and others. It appears that a wider range of plans are now subject to SAFE registration but no specific definition is given.

Circular 7 expressly stipulates that “onshore individuals” who participate in stock plans are directors, supervisors, senior management and other employees of domestic companies, including PRC citizens, Hong Kong, Macao and Taiwan citizens and foreign individuals. By this definition, any individual working for a PRC company and participating in an overseas stock plan, no matter whether he is a PRC or non-PRC citizen, will be subject to the SAFE registration requirement.

In addition, when defining “domestic companies,” Circular 7 expressly includes Chinese branches or representative offices and affiliates of offshore listed companies with “de facto control” relationships.

### Application Process Simplified

Circular 7 still requires onshore individuals and companies to submit an application package to local SAFE, to register the stock plan, while simplifying the application requirements in Circular 78. Applicants no longer need to provide broker agreements, a description of internal risk control systems or a form of stock or option agreement for SAFE review.

Circular 7 also repealed requirements for onshore asset managers, offshore designated banks and offshore designated bank accounts under Circular 78, which gives applicants more flexibility on payment and use of funds for stock plans.

### Source of Funds Broadened

Circular 7 expressly allows individuals to use their own foreign currency savings to participate in offshore stock plans. In this way, individuals can transfer funds in foreign exchange into the designated account directly without having to convert their RMB funds into foreign exchange first.

### Regular Monitoring Reinforced

While streamlining the application process, SAFE imposed a higher regular filing requirement by moving up the submission deadline for quarterly reporting in Circular 7. Onshore companies now have to file with local SAFE within the first three working days of every quarter instead of ten working days as required under Circular 78.

Furthermore, banks of domestic companies are also required to file the status of designated bank accounts with the local SAFE within the first three working days of each month. The local SAFE should report these filings to central SAFE within the first five working days of every month.

While making endeavors to perfect the registration process, Circular 7 still leaves some open questions to applicants. For example, Circular 78 expressly prohibits individuals from participating in offshore stock plans by paying from an offshore account directly to the plan. The restriction was removed in Circular 7; however, it is unclear whether such participation with individuals' offshore funds is officially allowed by SAFE under Circular 7. Circular 7 is also silent on whether existing applicants should amend or re-apply for their SAFE registration or the timeframe for SAFE to review and approve the application for offshore stock plans.

For more information on Circular 7, please visit the following Chinese language link:

[http://www.safe.gov.cn/model\\_safe/laws/law\\_detail.jsp?ID=8040400000000000,32&id=4](http://www.safe.gov.cn/model_safe/laws/law_detail.jsp?ID=8040400000000000,32&id=4)

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