

# SAFE issues new rules on share incentive plans offered by overseas listed companies

The State Administration of Foreign Exchange (**SAFE**) promulgated the *Circular on Issues related to Foreign Exchange Administration of Domestic Individuals Participating in Share Incentive Plans of Overseas Listed Companies*<sup>1</sup> (**Circular 7**) on 15 February 2012. Circular 7 provides a clearer regulatory framework for overseas listed companies to implement share incentive plans (**SIPs**) for employees in China. It streamlines the foreign exchange control process applicable to SIPs implemented by offshore listed companies and extend the foreign exchange registration requirement to a wider range of SIP types (including phantom awards in foreign currency to employees in China) and certain foreign nationals residing in China.

## Circular 78 and Circular 2 repealed

The foreign exchange control framework for employee share option plans and employee share ownership plans offered by overseas listed companies was first set out under the *Measures for the Administration of Foreign Exchange for Individuals*<sup>2</sup> and its detailed implementation rules<sup>3</sup>, respectively issued in December 2006 and January 2007. The detailed documentation and procedural requirements were set out under (i) the *Operating Procedures for the Administration of Foreign Exchange Issues Related to Domestic Individuals Participating in the Employee Stock Ownership Plan and the Stock Option Plan of Overseas Listed Companies*<sup>4</sup> (**Circular 78**) issued by the Capital Account Management Department of SAFE in March 2007, and (ii) a subsequent SAFE circular dated 7 January 2008<sup>5</sup> pursuant to which SAFE delegated its approval authority under Circular 78 to the local SAFE offices (**Circular 2**). Circular 78 and Circular 2 have been repealed in their entirety with the promulgation of Circular 7.

## Key Changes under Circular 7

Compared to Circular 78 and Circular 2, Circular 7 has introduced a number of changes to supervising and monitoring the implementation of SIPs, as follows:

- registration of SIP required

While Circular 78 was silent on the registration requirement, Circular 7 provides that the domestic agent must attend to foreign exchange registration (which, in practice, is similar to but simpler than obtaining an approval) with the local SAFE office on behalf of all employees located in China who participate in the relevant SIP. The domestic agent must either be one of the domestic companies (see definition below) participating in the SIP or an institution which is capable of carrying out asset custodian business lawfully chosen by the domestic company.

## Key Issues

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If you would like to know more about the subjects covered in this publication, please contact:

### Hong Kong

**Kenneth Leung** +852 2826 3565

**Tina Wong** +852 2826 2476

### Beijing

**TieCheng Yang** +86 10 6535 2265

If you would like to know more about our China publications, please contact:

**Chlorophyll Yip** +852 2826 3426

Clifford Chance, 28th Floor, Jardine House,  
One Connaught Place, Hong Kong SAR  
[www.cliffordchance.com](http://www.cliffordchance.com)

<sup>1</sup> Hui Fa [2012] No.7

<sup>2</sup> Order of the People's Bank of China [2006] No. 3

<sup>3</sup> Hui Fa [2007] No. 1

<sup>4</sup> Hui Zong Fa [2007] No. 78

<sup>5</sup> Hui Zong Fa [2008] No. 2

- Wider types of SIP covered

While Circular 78 applied to employee share option plans and employee share ownership plans only, Circular 7 extends its application to all other types of incentive plans permitted under law including share appreciation rights, restricted stock (units), performance shares (units), phantom shares, employee share purchase plans and other equity incentive plans.

- Definition of "domestic companies"

Domestic companies under Circular 7 now include overseas listed companies which are registered in China, branches (including representative offices) of overseas listed companies in China, and the Chinese parent, subsidiary or partnership enterprise which has a controlling or actual controlling relationship with the overseas listed company.

- Foreign nationals

The SAFE approval regime under Circular 78 did not apply to foreign nationals. The regulatory regime under Circular 7 now extends to non-PRC nationals (including Hong Kong, Macao and Taiwan residents) who have resided in China for more than a year on a continuous basis.

- Documentation requirement

Circular 7 no longer requires the applicant to submit (i) the full agreement between the overseas listed company/domestic agent and the custodian/manager of the SIP; (ii) the template employee participation agreement; and (iii) the internal control system of the domestic agent. Applicants are now required to summarize the relevant information in the Foreign Exchange Registration Form thus resulting in substantial savings in translation costs.

- Payment with self-owned foreign currencies allowed

Circular 7 permits participating employees to use self-owned foreign currencies held in their individual foreign exchange bank accounts in China to make payments under the relevant SIPs.

- Changes and cancellation of SIP forex registration

Circular 7 requires the domestic agent to register all substantial changes (such as those caused by changes in the key terms and conditions of the SIP, merger and acquisition of the overseas listed company or the domestic agent) with the relevant local SAFE office. Upon the termination of an SIP, SIP forex registration must be cancelled with the local SAFE office. Both registration and cancellation must be conducted within the prescribed time limit.

- Reporting time tightened

The domestic agent must submit a filing form within three business days (compared to ten business days under Circular 78) at the beginning of each quarter providing information on the implementation of the SIP(s) that have already been registered with SAFE.

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