Tips for Tackling China SAFE Registration

China and India are often grouped together, either as part of the "BRIC" countries (along with Brazil and Russia), or as twin emerging forces in global markets. Recent regulatory changes have put them near the top of "difficult" countries from an equity compensation point of view, for reasons having to do with everyone's favorite topic: money. China is trying to get a better view of funds flowing in and out of the country, while India wants to ensure it is getting its fair share of taxes by shifting taxation on equity income from employees to employers.

China implemented new exchange control regulations requiring foreign companies to complete registration with the State Administration of Foreign Exchange (SAFE) and ensure all funds flowing in and out of China go through a registered foreign exchange bank account. India, which had liberalized foreign exchange rules in the recent past, expanded its existing Fringe Benefits Tax (FBT) regime to include income from equity based compensation.

China SAFE Registration: What & Who?

What exactly is SAFE? It is a governing body which directs and controls all foreign exchange regulations in China. There is a federal office and local, provincial offices. Similar to the U.S., where states can have varying implementations of federal guidelines, local SAFE offices have different rules regarding specific registration requirements, making it even more challenging for multinational companies to comply.

Under the broad requirements, foreign issuers must register all equity incentive plans offered to Chinese national employees; this includes options, restricted stock, RSUs, SARs, ESPPs, and potentially, cash plans offered by the parent company. Additionally, the company must establish a foreign exchange account through which all funds for purchase or from sale of equity must flow. The regulations apply to all public multinational companies; registration is currently not available for private companies.

A mountain of documentation must be submitted with the application. Documents required include: a copy of your agreement with your broker and statements of risk management and internal controls for repatriation of funds, copies of Board resolution(s) approving your stock plan(s), translated copies of plans and agreements, a letter confirming the labor relationship with your participants, and a list of employees by entity.

Issuer Challenges and Concerns

SAFE registration is no easy task. From a survey conducted by SOS in March, 2009, of 22 firms who currently grant or have granted in China, only three companies had completed registration, while six were in process. Of those who had begun the process, half had spent 6-12 months, while the other half spent 12-24 months.

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What are the driving factors behind this lengthy registration? One of our survey respondents summarized the process with this statement: "Ancient Chinese proverb: No good deed goes unpunished. We've started twice but continue to go very slowly, primarily as a result of the stories we've heard about issues encountered by those who forged ahead and because there seems to be no truly friendly provincial tax authority." Indeed, the varying requirements between local SAFE offices are causing companies major headaches, since registration must be completed in each province where the company has employees. Other challenges faced by companies trying to be compliant include the cost of translating plans and agreements: We have heard estimates as high as $30,000.

Another big concern for issuers is ensuring all funds flow through the foreign exchange account, even for terminated employees. Employers may need to mandate same-day sales for options or immediate sale on vest/purchase for RSU/ESPP shares. If employees are allowed to hold shares, the company may need to force a sale on termination or make some other arrangement with the broker to transfer funds only through the corporate account; this may entail modifying the broker contract. Once funds have been deposited to the foreign exchange account, the company must then facilitate the transfer of funds to individual accounts.

If your company is starting to review these requirements, take a deep breath and proceed with caution. Consider reviewing alternative compensation methods such as a local cash bonus program or phantom stock. Perform a cost-benefit analysis to look at all the costs (monetary and resources) versus the benefits (corporate culture of ownership, competitive employment market). Engage your vendors too-they may have solutions or tools that can help. Remember, this is a long process and deserves a detailed review as well as a strong commitment from all internal stakeholders, not just stock plan management, to complete.

If you have questions on any portion of this article, please e-mail us at: xtra@sos-team.com.

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