



New “SAFE” Regulations and Guidance

Regulations of the People’s Republic of China on Administration of Foreign Exchange of 1997 classify foreign exchange transactions into two categories: (i) current account transactions (recurring and non-investment in nature), and (ii) capital account transactions (investment in nature). For current account transactions, the State Administration of Foreign Exchange (“SAFE”) normally delegates to authorized commercial banks the right to review the transaction. For most capital account transactions, however, prior approval from SAFE must be obtained unless an exemption applies.

The conversion of funds and remittance of funds offshore are regulated differently depending on the classification of the transaction. Pursuant to new foreign exchange regulations effective as of February 1, 2007 (the “New SAFE Regulations”), each individual (including domestic individuals and foreign individuals resident in China), is allowed an annual quota of US \$50,000 for the conversion of foreign currency into RMB for current account transactions. PRC domestic individuals are also allowed an annual quota of US \$50,000 for converting RMB into foreign currency and remitting such amount offshore for current account transactions. Within such quotas, the relevant individual may directly go to a foreign exchange bank and handle the relevant conversion and remittance. For current account transactions that are over the annual quota, the individual may go to a foreign exchange bank and provide transaction documents and then handle the conversion and remittance.

For conversion and remittance under capital account transactions, different procedures under the New SAFE Regulations apply based on the nature of the transactions (for example, participation in employee equity awards, buying insurance products using foreign currency, injection of capital into offshore shell companies for purpose of “round-trip investment” etc.).

PRC nationals are now expressly permitted to invest in foreign fixed income products or stocks if they are offered through Qualified Domestic Institutional Investors (“QDII”), such as banks and fund management companies holding relevant licenses. Individuals may purchase “investment units” offered by such institutional investors, who are the direct bond holders or shareholders. Such investments would be considered capital account transactions.

In early April 2007, SAFE issued an internal procedural guideline to set out the procedures specifically relating to employee equity incentive plans offered by foreign-listed companies to their PRC employees. The internal guideline is called “*Operation Procedures for Administration of Domestic Individuals Participation in the Employee Share Ownership Plan or Share Option Plan of an Overseas Listed Company*” (“SAFE Guidance”). The SAFE Guidance provides detailed procedures for handling foreign exchange matters relating to employee equity incentive plans offered by offshore listed companies to PRC employees. However, there are still some uncertainties under the SAFE Guidance.

The SAFE Guidance further clarifies that the transfer of funds abroad in relation to a PRC citizen’s participation in a foreign-listed company’s employee SO/RS plan or SPP would be considered a capital account transaction. SAFE approval for currency conversion and remittance must be applied for by the onshore foreign employer or a domestic third party intermediary company entrusted by the relevant employer. In addition, the foreign exchange proceeds obtained by PRC citizens from the sale of foreign stocks and from dividend distributions under an SO exercise or SPP should be remitted to a special foreign exchange bank account opened by the onshore foreign employer or the domestic third party intermediary, after which it may either be converted into RMB (and then distributed to the PRC employees) or remitted into the foreign currency deposit accounts of the PRC participants opened in an onshore bank. However, there is currently no procedure in place for the employer or domestic third party intermediary to open such an account.

Finally, please note that the New SAFE Regulations also regulate the foreign exchange activities of foreign individuals in relation to current account transactions. It is not certain whether the above approval procedures under the SAFE Guidance apply to PRC domestic individuals only or all PRC employees, regardless of whether they are PRC domestic or foreign individuals.

It should be noted that in late August China announced a pilot program to allow individuals to open special capital accounts in certain banks in Tianjin to make portfolio investment to the stocks listed on the Hong Kong Exchange. Individuals conducting such investment will not be subject to the foreign exchange quota of US \$50,000. It is widely expected that this new program will be implemented by the end of 2007.