

China SAFE Workshop



New York
October 26, 2010

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Agenda

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- **Determine If Awards Fall Under Circular 78**
- **Prepare for Filing**
- **Where to File**
- **SAFE Filing Process**
- **Issues/Requirements for Flow Of Funds/Conversion Of Funds**
- **Plan for Issues/Fund Flow**
- **Choices for Tax Withholding**
- **Choices for Distribution Of Net Proceeds**
- **Cashless Option Procedure Flow Chart for Participants In China**
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- **Outstanding Awards**
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Circular 78

- Adopted in April 2007 by the State Administration of Foreign Exchange (“SAFE”)
- Regulates offerings of equity plans by companies outside of China to employees who are Chinese nationals.
- Purpose – Regulate and control and have visibility for flow of funds related to these types of plans.
- SAFE approval required for offering equity plans to Chinese nationals.
- Prior to April 2007, most advisors thought OK to offer equity incentives in China provided no funds leaving China.
- Can get SAFE approval for any type of employee equity program, even an ESPP.
- Does *not* cover offerings to non-Chinese nationals in China.
- Does *not* cover cash bonus programs offered and funded locally.
- Does *not* cover private companies (but still may be technically required to get SAFE approval if private).

Determine If Awards Fall Under Circular 78

- Outstanding equity awards held by Chinese nationals?
- If “no” to (1), plans to make grants?
- If “yes” to (1 or 2), does company have a sufficient number of award holders in China to justify cost/time to make filing?
- If “no” to (3) need exit strategy in China for equity awards. no more new grants and alternative award types.
- If “yes” to (3), time to gear up for filing.

Prepare for Filing

- **Take ownership**
- **Learn from others**
- **Understand issues and regulations**
- **Get senior level buy-in**
- **Get senior level buy-in**
 - Describe issues
 - Discover and articulate alternatives
- **Connect with local stakeholders**
- **Get your team together**
- **Manage internal expectation**

Where to File

- Each SAFE province has slightly different requirements for application contents, ongoing obligations, allowable terms for awards, etc.
- More importantly, SAFE provinces have varying levels of experience in accepting applications for U. S. multinationals.
- Shanghai and Beijing have most experience and approval process is pretty streamlined. Typical response period after filing is approval in 2 weeks – 3 months for Shanghai or Beijing.
- Other provinces, less experienced; expect 6 months until approval and possible “bumps in the road”
- Companies can choose to file in any SAFE province in which they have a legal subsidiary (called a “WOFE” – wholly-owned foreign entity) and employees that have/will be receiving equity grants.
- Consider where you have the ideal company representative.

SAFE Filing Process

- File an application with a provincial SAFE office
- In person meeting(s)/negotiation with provincial SAFE (keep in mind SAFE offices can ask for anything they want!)
- May receive comments to application
- Receive approval (not the end, but the beginning of a new relationship with SAFE)
- Open up dedicated bank account in China
- Make sure all proceeds from stock sales related to equity plans are going through dedicated account in China and obtain approval to convert funds into RMB (if desired)
- Comply with ongoing obligations

Issues/Requirements for Flow of Funds/Conversion of Funds

- All proceeds from the sale of shares required to be repatriated through dedicated SAFE Account in China.
- Net share issuances/tax withholding from proceeds prior to repatriation into SAFE Account not permitted.
- Proceeds sent into SAFE Account will include (1) income tax withholding amount that must be paid to Chinese tax authorities; and (2) net proceeds (less tax withholding) to be distributed to employees.
- These funds [(1) and (2)] will be in U.S. dollars when deposited into SAFE Account.
- Need SAFE approval every time to convert funds to RMB.
- Approvals for conversion of funds limited to quarterly in Shanghai; may take up to 20 working days to get approval after request submitted (applies in every province).
- Proceeds to employees may be paid to employees in U.S. dollars or converted into RMB (after approval received) and then distributed to employees either through local payroll or outside of payroll.
- Tax withholding amounts must be paid to Chinese tax authorities in RMB and tax amounts must be paid to Chinese authorities within 7 days after end of month in which taxable event occurs (generally, vesting for RSUS and exercise for options).

Plan for Issues/Fund Flow

- **Map out project timeline and deliverables**
 - Recognize the process is not linear
- **Flow out process and validate with vendors, consultant/legal**
- **When filing:**
 - Don't under-estimate the importance of your designated company applicant(s) to understand Equity and proposed process

Choices for Tax Withholding

- Withhold from paychecks
- Withhold and pay out of SAFE account
- Require employees to come up with tax withholding amounts out of pocket

Choices for Distribution of Proceeds

1. Convert the funds (after SAFE approval) into RMB and pay to employees through payroll or outside payroll process (if desired).
2. Pay funds out in U.S. dollars (no conversion). Employees will have to open U.S. dollar bank accounts in China (which many high level employees in China probably already have). Chinese individuals can convert up to US\$50,000 per calendar year into RMB without any approvals/issues.

Dedicated Bank Account in China Required

- **Cannot officially open until SAFE approval received, but can “reserve” an account pre-approval**
- **Most popular Chinese banks for dedicated SAFE accounts for US multinationals:**
 1. **Bank of America**
 2. **Bank of China**
 3. **Citibank**

Plan/Award Terms to Offer in China

Special Option Terms for China

- Cashless sell-all recommended
- Depending on province, post-termination exercise period may need to be limited to 6 months (Shanghai) even for outstanding grants. Try to negotiate with SAFE.

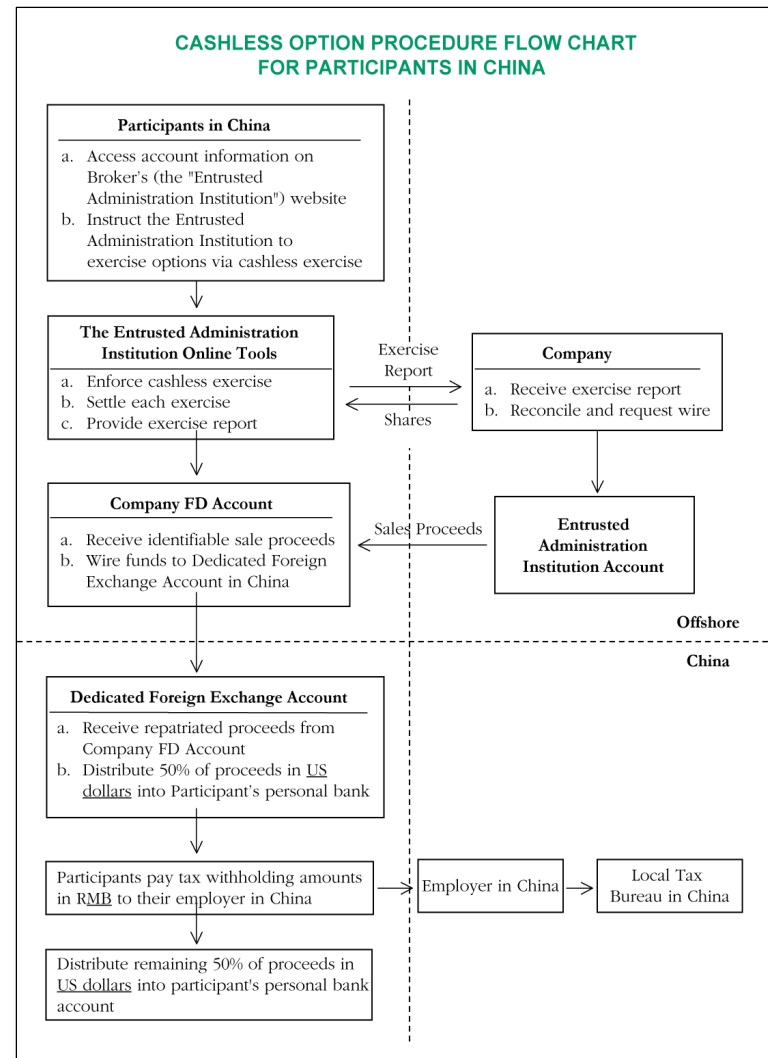
Special RSU Terms for China

- Will have to decide to either (1) force sale of shares at vesting; or (2) track shares after issuance *forever* and when shares are eventually sold, ensure proceeds are repatriated through SAFE Account.
- If elect (2), depending on province, probably have to force sales of shares within certain period of time after termination of employment (generally, within 6 months).

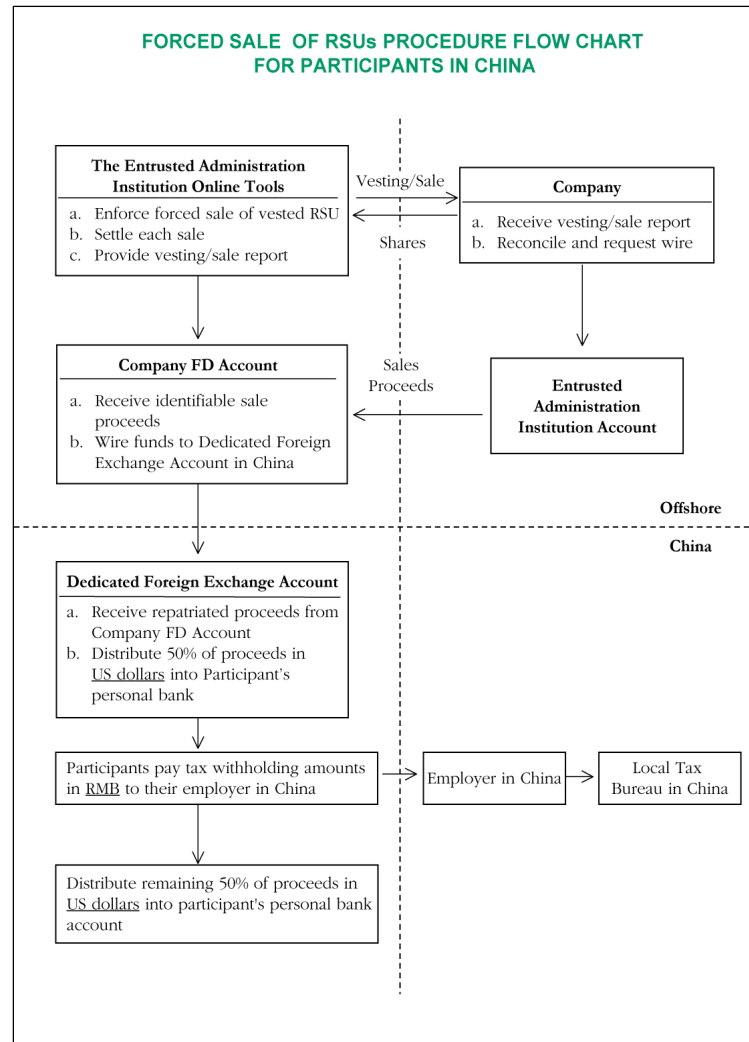
Special ESPP Terms for China

- Quick sales at purchase usually required by companies offering ESPPs in China.

Cashless Option Procedure Flow Chart for Participants in China



Forced Sale Of RSUs Procedure Flow Chart for Participants In China



Outstanding Awards

- **Disclosure – Will likely have to disclose in SAFE filing and provide a statement about why your company has outstanding grants without SAFE approval and reps that all proceeds received from prior equity awards were repatriated into China and taxes paid.**
 - ✓ Don't represent what you can't confirm.
- **Terms – Post-termination forced sales/reduction in post-termination exercise periods *will* apply to outstanding grants.**
 - ✓ Work with broker if employees have not agreed in writing to forced sale to ensure the forced sale can occur.
- **Shares Outstanding – Probably do not have visibility/control, so be careful about reps in application and treatment of outstanding shares.**

Ongoing Compliance

- **Depends on province**
- **Most rigorous ongoing compliance requirements are in Shanghai:**
 - Annual approval of a quota of outgoing and incoming funds
 - Quarterly reports signed by broker of incoming funds
- **Conversion of funds**
 - Must obtain approval in advance of each conversion (Shanghai: only to give approval once each quarter) Provinces can take up to 20 working days to respond to approval request. New entities in China/new employees/corporate restructuring.
- **May need to amend/supplement SAFE application**

Questions?

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