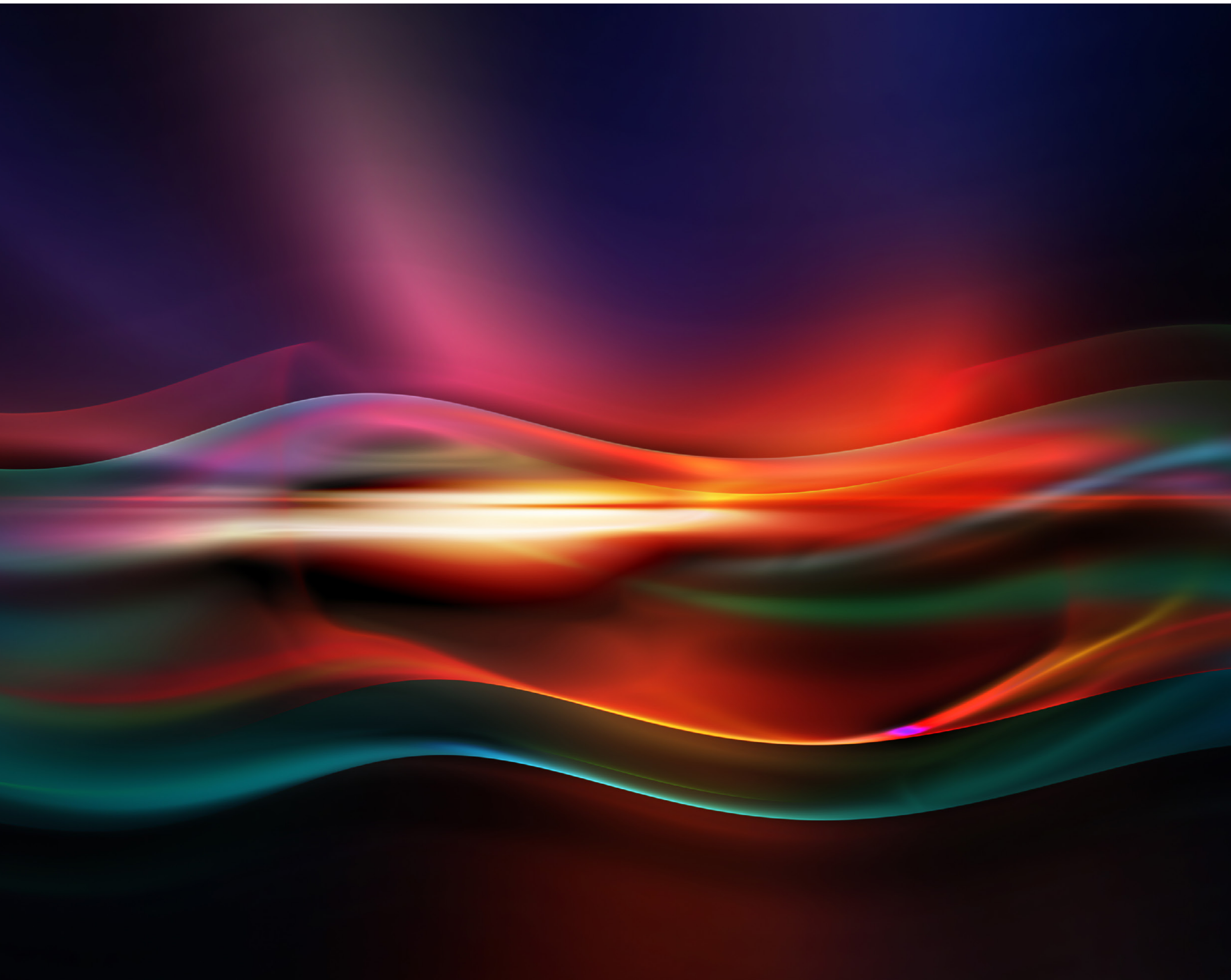
Offering Share-Based Awards to Employees in Vietnam



Contents

Introduction

For non-Vietnamese companies looking to offer share-based awards to employees in Vietnam, the main challenge is the restrictions and requirements imposed by the State Bank of Vietnam ("SBV"). With the enactment of Circular 10 in 2016, the requirements are clearer than under the prior rules, and the SBV has provided further input on the filing processes in the years since 2016. However, the registration application with the SBV and the ongoing compliance and reporting obligations continue to require a significant amount of resources and attention from the issuer company and its local Vietnamese entities, and there remain pitfalls and challenges companies need to understand and be prepared to tackle whether they pursue a SBV registration or not.

Background

Even before 2016, the SBV long restricted the flow of funds out of and into Vietnam in connection with employee share plans and required non-Vietnamese companies offering share-based awards to Vietnamese national employees to obtain its approval prior to implementing such plans. To secure approval under the "old rules," the SBV often required that the issuer company impose a mandatory cashless sell-all exercise restriction on stock options and a forced immediate sale restriction on shares issued at settlement of restricted stock units ("RSUs"). In addition, the SBV did not permit any Vietnamese nationals to remit funds from Vietnam for the purchase of shares, which effectively prohibited non-Vietnamese companies from offering employee stock purchase plans ("ESPPs") in Vietnam. The requirements for obtaining approval under the "old rules" were not well documented and could shift from registration to registration.

On June 29, 2016, the SBV issued Circular No. 10/2016/TT-NHNN guiding the implementation of Decree No. 135/2015/ND-CP on offshore indirect investment, which took effect on August 13, 2016 ("Circular 10"). Under Circular 10, the SBV considers share-based awards offered by a non-Vietnamese company to Vietnamese national employees resident in Vietnam as "offshore indirect investments," which are subject to exchange control registration requirements. In particular, the local entities are required to obtain prior approval from the SBV. Given the absence of specific regulatory guidance, grants to non-Vietnamese nationals practically speaking are not subject to the SBV registration requirements, nor can such individuals be included in a SBV application.

Although the purpose of Circular 10 was to make it easier for non-Vietnamese companies to offer share-based awards to Vietnamese nationals and presumably permit the offering of ESPPs, we have found that the requirements imposed by the SBV can be administratively burdensome to comply with and continue to impose significant restrictions on the offering of share-based awards to Vietnamese nationals.

SBV Registration Process

Each "local presence" of a non-Vietnamese company must submit a separate application dossier with the SBV in connection with the employee share plan(s) offered by the non-Vietnamese company. For purposes of Circular 10, a local presence eligible for a SBV registration includes a foreign-invested economic entity, branch, representative office, or an operation office of a foreign party to a business cooperation contract. If a company has multiple local presences in Vietnam that employ award recipients, each entity must submit an application dossier with the SBV, and each entity must separately comply with the terms of the SBV's certificate of registration and any ongoing reporting requirements (including the establishment of a dedicated bank account for funds related to the plan, as further described below).

Application Dossier

According to Circular 10 and the registration requirements of the SBV (which it may adjust from time to time in its discretion in light of the applications it reviews), the following information/documents are generally required to be submitted as part of an application dossier:

1. Registration application, on a prescribed form;
2. Enterprise registration certificate and investment registration certificate of the local entity;
3. Secretary's certificate of the non-Vietnamese company with the following exhibits:
   - Certificate of establishment and good standing;
   - Certificate of incorporation (or articles of association / articles of incorporation) indicating par value of shares;

- Copy of the equity plan;
- Copy of the board resolutions adopting the equity plan;
- Copy of the award agreement; and
- Copy of the board resolutions approving the award agreement.

4. List of Vietnamese employees participating in the equity plan;
5. Power of attorney (if the application dossier is submitted through a service provider other than the local entity); and
6. Any other documents or information, as requested by SBV.

The secretary's certificate and its exhibits need to be translated into Vietnamese language before submission with the SBV. The translation of the exhibits under the secretary's certificate further needs to be certified. In addition, there are specific requirements on how each document has to be signed and stamped, and how many originals or copies of each document must be included in the dossier. Generally, the enterprise registration certificate and investment registration certificate of the employing entity, as well as the secretary's certificate of the non-Vietnamese company, need to be notarized. Lastly, if the secretary's certificate is signed outside of Vietnam (e.g., in the U.S.), it and its exhibits will need to be authenticated and apostilled (e.g., by a Secretary of State) and then consularized by a Vietnamese embassy or consulate.

Approval and Post-Approval Steps

Within five working days from the submission of the application dossier, the SBV has the right to request additional materials and information if it deems the dossier insufficient in any respect. In practice, companies should be prepared to answer multiple rounds of SBV questions and comments and to provide additional documents and information as requested.

Once the application dossier is fully assembled (i.e., after all of the information and documentation requested by the SBV have been provided, and all questions answered to its satisfaction), the SBV will issue a certificate of registration within 15 working days from the date it receives the package. The certificate of registration will set forth the terms and conditions of the local entity's registration and stipulate any ongoing obligations.

After the local entity receives the certificate of registration, it will need to provide a copy to its local commercial bank and open a dedicated foreign currency bank account for the implementation of the plan. Once established, this account must be used to process all cross-border funds related to the plan. For instance, sale proceeds and cash dividends need to be repatriated from the offshore broker first to this onshore dedicated bank account in Vietnam, before further distribution to the participating employees.

Ongoing SBV Requirements

Following the approval of the implementation of the plan and the establishment of the dedicated bank account, there are ongoing requirements. Specifically, the local entity must perform the reporting obligations as required under the certificate of registration (e.g., in connection with any change to the employee list, the dedicated bank account, contents of the certificate of registration, terms and conditions of the plan documents, and termination of the equity plan) as well as under Circular No. 10/2016/TT-NHNN (i.e., the implementation status of the equity plan).

Quarterly Report

The local entity will be required to submit prescribed quarterly reports to the SBV. The report requires the disclosure on any exercise of options (e.g., number of shares acquired, fair market value of the shares, any exercise price paid) and the sale of shares (e.g., number of shares sold and sale price) over the prior quarter and the remittance of funds into and out of the dedicated bank account. The reports are due within twenty days of the close of each quarter. A nil report is required if there has been no reportable activity during any given calendar quarter.

Employee List Updates

Although the update of the employee list is not addressed in Circular 10, in practice, the SBV has requested many companies in their certificates of registration to update their employee lists, including the addition of new employees and the removal of terminated employees, on a quarterly basis at the same time as they submit their quarterly reports.

Recently, the SBV has started to require companies to provide a reason for the removal of employees from the list.

Ad Hoc Reports and Notifications

Certain material changes to the operation of the plan in Vietnam, such as a change of the dedicated bank account, termination of existing plan, etc., require ad hoc reports to be submitted with the SBV, generally within five business days of the occurrence, but the requirements may vary and depend on the conditions set forth in the certificate of registration issued to the local entity.

Although not specified under Circular 10, a notification generally also is required to update the SBV on material changes to the content of the certificate of registration (e.g., changes to the names and the addresses of the issuer company or the local entities), or to material terms and conditions of the plan and award documents.

New Entities

Any time the non-Vietnamese company forms or acquires a new local entity in Vietnam, it is required to complete and submit a new application dossier, as long as such new entity has employees to whom the company would like to offer awards.

Practical Challenges and Considerations

Other than the more or less standardized requirements regarding the initial application and post-approval reporting and compliance obligations, there are other important aspects to which companies should pay close attention, in order to facilitate the implementation of their share plans in Vietnam.

Implementation Through Local Entity

Circular 10 provides that "the plan must be implemented through the local entity." The SBV has occasionally taken the conservative interpretation that all activities in connection with the award (including the sale of shares) must therefore be managed and conducted by the local entity, rather than the participating employees.

Accordingly, the SBV may expect the local entity to request the sell order for company shares, instead of the employees themselves. This means that a participating employee would need to instruct the local entity first if he/she wants to sell shares, and the local entity would then need to instruct the offshore broker to place the sell order. It is not clear how mechanically the local entity could place the sale orders with the offshore broker on the employees' behalf. However, given this could be SBV's position, companies need to be prepared to prove the involvement of the local entity.

In connection with this interpretation, the SBV may further require companies to revise their plan and/or award agreements to implement this requirement.

Holding of Long Shares

Most companies prefer that employees be able to hold shares after they are acquired under the plan, so their interests are more closely aligned with other shareholders. As noted, this was problematic under the old rules, but since implementation of Circular 10, as a general rule, the SBV has no longer required the immediate sale of shares upon issuance.

Even if the SBV does no longer prohibit the holding of shares, companies may consider whether a forced sale requirement may simplify administration of the plan in Vietnam. For instance, the requirement to implement the plan through the local entity (as discussed above) may make a subsequent sale of shares less straightforward. Further, in connection with terminated employees, companies may have to require such employees to dispose of their shares on the date of termination or within a certain period after termination (this is not clearly prescribed in Circular 10, but could be requested by the SBV). Companies need to ensure they can still repatriate sale proceeds for such terminated employees to Vietnam once their names are removed from the list of participating employees. If shares are immediately sold upon issuance, these issues will not arise.

Restrictions for Stock Options

The SBV considers stock options to be an award to buy shares which must be offered at "favorable conditions." To ensure that the stock option is subject to favorable conditions, the SBV may require that all or some of the shares be immediately sold at exercise (i.e., impose a full or partial same-day sale). This is to prevent that employees could lose their investment in the shares, in case the stock price decreases after shares are acquired at exercise. Aside from the SBV potentially requiring such an exercise restriction, it is also advisable from a practical perspective because allowing employees to pay the exercise price in cash (which requires an outbound remittance of funds from Vietnam) will add more complexity to the administration of the plan in Vietnam. Therefore, in our experience, virtually all companies granting stock options in Vietnam are voluntarily imposing a same-day sale exercise restriction on options.

Eligibility and List of Employees

Under Circular 10, grants made under share plans are considered "awards," and the SBV is of the view that companies cannot allow all employees in Vietnam to receive awards. In its letter responding to a recent registration application, the SBV stated that allowing all employees to participate in a share plan meant that the non-Vietnamese company was mobilizing investment capital from the local entity's employees. Although this is not an accurate characterization of awards granted by most non-Vietnamese companies, it appears to be the SBV's current interpretation. In light of this, companies may be required by the SBV to impose certain eligibility criteria on employees in Vietnam to receive awards. Further, in practice, the imposition of such criteria must result in a certain number of Vietnamese employees not being eligible to receive awards. The percentage of employees that should be restricted from participation appears to fluctuate depending on the application and circumstances of the applicant company.

In this regard, recall that companies are generally allowed to update with the SBV their list of participating employees on a quarterly basis, which means that companies may be able to later add at least some of the employees who may have been excluded under the initial application dossier. However, as discussed above, companies need to be prepared to provide reasonable explanations for the addition of employees in the event of an SBV inquiry.

ESPP Feasibility

Although there is no prohibition against the offering of an ESPP, there remain practical difficulties with respect to the offering of an ESPP in Vietnam.

ESPPs are typically designed to be offered to all full-time employees, so the SBV requirement to restrict eligibility to less than all employees (discussed above) could be problematic.

Further, if a company allows Vietnamese employees to hold shares acquired under the ESPP after purchase, there is a chance the employees could lose their investment when they sell shares at a price lower than the purchase price. Due to this risk, the SBV could take a conservative view that the ESPP is not considered an "award to buy shares with favorable conditions," and request that the company force the immediate sale of shares upon purchase (at a time when there is no risk for loss).

Last but not least, payroll deductions are not expressly mentioned under Circular 10 as a way for employees to fund the purchase of shares, so the SBV could take a narrow view and not allow payroll deductions. In this case, employees may have to make contributions directly to the dedicated bank account (e.g., by check or wire), before such contributions are remitted to the issuer's country for the purchase of shares.

In light of these additional challenges, in our experience, most companies so far have pursued approval only for RSU and/or option awards, and not for their ESPP even if they offer an ESPP in other jurisdictions.

Grants Before Registration

For companies with a fast growing employee population in Vietnam, it is often the case that, by the time they make the decision to obtain the registration approval with the SBV, they have already granted awards to some Vietnamese nationals, unaware of the implications of such a grant. Although we continue to see relatively little enforcement action by the SBV, companies are strongly encouraged to grant awards to

Vietnamese nationals only after obtaining approval, as the SBV can reject registration applications in the presence of outstanding awards. It may be advisable in this case to consider cashing out the existing awards to mitigate any risk (but U.S. companies should be mindful of U.S. tender offer requirements for such cash-out offers).

Alternative to SBV Registration

Companies that are not ready to undertake the SBV registration process may consider granting only cash-settled awards. Although not entirely clear, cash-settled awards documented by carefully drafted award agreements arguably fall outside of Circular 10 and, thus, a registration requirement with the SBV, provided that the payment is made by the local entity through local payroll with no cross-border remittance of funds.

Other Issues

There are also other regulatory and tax issues to consider in connection with the offering of share-based awards by a non-Vietnamese company to employees in Vietnam. We briefly mention them below.

From a securities law standpoint, share-based awards may be offered by non-Vietnamese companies in Vietnam, provided they meet the requirements in Article 26 of Decree No. 58/2012/ND-CP guiding the implementation of the Law on Securities: (i) the implementation of rights attached to the awards must comply with Vietnamese foreign exchange control regulations; and (ii) awards and securities acquired by Vietnamese national employees may not be transacted in the Vietnam securities market.

On the tax side, note that the Vietnamese tax authorities have changed their guidance over the years. Based on the most current guidance made available to us, tax generally is due on share-based awards only when the shares acquired from such awards are subsequently sold. The taxable income (due at sale) is bifurcated: (1) the employees are subject to personal income tax on the value of share-based awards as expensed by the granting company or on the par value of the shares underlying the award, and (2) the employees are subject to personal income tax on the securities transfer income which is equal to 0.1% of the sale proceeds. The local employing entity is not required to report the income from share-based awards or withhold any personal income tax due on such income. Instead, tax must be declared and paid by the employees.

Conclusion

Vietnam is becoming an increasingly important market for talent, and we have witnessed growing demand for the offering of share-based awards to employees in Vietnam in recent years. Since the adoption of Circular 10, the SBV registration process have been clarified to some extent, and a growing number of companies has successfully registered their plans with the SBV.

That said, companies should be cognizant of the remaining obstacles and challenges in offering awards in Vietnam, ideally before they are making any grants. It is important for companies to weigh the costs and benefits of obtaining SBV approval, given that the application process remains a significant undertaking and the ongoing reporting requirements necessitate continued resources.

Contacts

Authored by Kela Shang and Barbara Klementz, with special thanks to our colleagues Tri Trung Pham and Khanh Chi Vu in our Hanoi office for their contributions to this article. For more information:

Barbara Klementz
Partner

San Francisco
barbara.klementz
@bakermckenzie.com

Kela Shang
Partner

Palo Alto
kela.shang
@bakermckenzie.com

Baker McKenzie helps clients overcome the challenges of competing in the global economy.

We solve complex legal problems across borders and practice areas. Our unique culture, developed over 70 years, enables our 13,000 people to understand local markets and navigate multiple jurisdictions, working together as trusted colleagues and friends to instill confidence in our clients.

bakermckenzie.com