China's Corporate Social Credit System

ASIA

On June 27, 2014, the PRC State Council published the outline of a plan for the building of a social credit system (SCS) to promote the integrity and credibility of the whole society by establishing a credit record infrastructure network using information technology to collect data from various groups, administrations, governmental bodies, courts, private companies, businesses, etc.

The SCS was designed as a key tool to improve social management while building trust in the government and regulating the conduct of businesses and individuals by creating a system based on data and algorithms instead of arbitrary assessment and decisions. Indeed, many Chinese people view the SCS as an effective tool to rebuild social standards, civic behaviors and morality in a country which mostly focused on its high-speed economic development so far.

The 2014 SCS plan is global and shall be applicable to individuals, businesses and government officials but will obviously differ as far as modalities are concerned (data collection, scoring system, rewards and punishments, etc.).

Focus here is made on the SCS applicable to business entities (Corporate SCS) even though it is worth noting that each SCS should eventually interact with one another. For instance, an individual with low social credit score holding a position of legal representative of a company will negatively impact the score of such company and vice versa.

The Corporate SCS follows 3 steps:

1. Definition of rating requirements by the government,
2. Monitoring of companies' behavior by collecting data,
3. Rating of the companies based on algorithms and consequences.

RATING REQUIREMENTS

Ratings tracked under the Corporate SCS cover many aspects of companies' activities and businesses in China, such as tax, customs authentication, product quality, work safety, e-commerce, cyber security, competition, R&D / Technology, etc. They are basically divided into 2 types:

<u>Topic-specific ratings based on scale</u> (such as tax, customs, environmental protection): companies shall be assessed based on continuous point or letter scales (eg. 0-1,000 points or AAA – D ratings) between good and bad behavior.

<u>Compliance records</u>: companies will be rated based on their compliance/non-compliance with PRC regulations and laws as many of them published since 2014 (including the Foreign Investment Law in effect from January 1, 2020) refer to non- compliance being recorded in the SCS database, thereby linking non-compliant behavior with the Corporate SCS. They also frequently refer to blacklisting mechanisms for severe non-compliance cases.

For instance, most recently, to control the news and social media in relation with the COVID-19 epidemic, the Cyberspace Administration of China promulgated on December 15, 2019 the *Provisions on the Governance of Network Information Content Ecology* effective on March 1st, 2020, which provides that illegal content released by network operators may affect their social credit records.

Worthy of note is the potential extraordinary requirement relating to the behavior of one company's 'business partners' which could be assessed for the purposes of such company's rating, meaning that the company would have to monitor its partners' trustworthiness and do something about it, in its own interest.

MONITORING COMPANIES

To monitor companies' behavior, the Chinese government plans to centralize various data platforms into a big-data-enabled surveillance infrastructure which shall collect, record, share between government authorities and publish rating results and records of companies.

Data collection efforts are not only the result of government departments, as the government is receiving important cooperation from China's technology giants such as Alibaba, Baidu, which share data and offer support. More recently in 2019, a new meta-database of the Corporate SCS, the national 'Internet+ Monitoring' system, has been established to integrate government and private company data on companies and is currently jointly developed by a consortium of technology advanced companies[1] .

The collect of data under the Corporate SCS has started with all companies registered in China having received a unique 18-digit 'Unified Social Credit Code' which is the sorting number for all databases related to the Corporate SCS.

Real-time monitoring is being tested, network activities on internet, mobile phone, wechat-type social networks, cloud systems, domestic and international emails should also be extensively collected and data collect should also take huge advantage of the development of the versatile IoT technology, i.e. smartphones, smart watches, self-driving cars, drones and surveillance cameras.

As far as individuals and hence legal representatives and other 'responsible personnel' are concerned, data collect makes/shall make full use of the latest technologies, such as facial recognition and deep-learning algorithm, voice-recognition programs and the building of a DNA and of biometric databases, etc.

Despite such ambitions, in practice, so far, monitoring is still mainly done in the traditional way, by using information and data directly collected from the companies through applications before, self-reporting to and/or inspections conducted by, a wide array of governmental authorities.

RATING AND CONSEQUENCES

The final step consists in rating the companies by comparing the collected information under step 2 with the requirements for good behavior defined by the relevant government under step 1.

In case of negative ratings, sanctions vary depending on the nature of the rating and the extent of negative ratings: penalties, court judgment in case of legal infringement, restrictions during administrative procedures to apply for approvals, permits and licenses necessary to conduct business, higher inspection exposure, targeted audits, exclusion from or forfeiting of preferential policies, exclusion from government procurement and public tenders, public blaming and shaming, prohibition from investing and participating in the Chinese market, etc.

In some instances, the legal representative (and potentially other 'responsible personnel') of the non-compliant company may face personal consequences, such as restrictions to purchasing insurance products, acquiring real estate or land, prohibition from taking on another position as legal representative, travelling restrictions, etc.

Furthermore, negative rating can lead to blacklisting under conditions which vary depending on the relevant topic.

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[1] *Taiji Computer, Huawei, Alibaba, Tencent and Vision Vera.*

Escalation to blacklisting results in the application of 'joint sanctions' by the relevant government authority directly responsible for the rating on one hand and by other governmental authorities on the other hand. For instance, a distrusted taxpaying company may, in addition to tax-related sanctions, face difficulties when applying for licenses, acquiring land use rights and its legal representative may be prevented from purchasing railway or airlines tickets in China.Escalation to blacklisting results in the application of 'joint sanctions' by the relevant government authority directly responsible for the rating on one hand and by other governmental authorities on the other hand. For instance, a distrusted taxpaying company may, in addition to tax-related sanctions, face difficulties when applying for licenses, acquiring land use rights and its legal representative may be prevented from purchasing railway or airlines tickets in China.

In some particularly severe cases of non-compliance such as the ones involving public safety, environmental protection and safe production, companies may face life-long market expulsion.

Non-compliance cases are fed into the national database of SCS followed by corresponding impact on the given company's scale rating results or by blacklisting.

The non-compliance and results are then published on topic-related specific platforms, local databases of the Corporate SCS and companies which are blacklisted or deemed as distrusted enterprise are flagged within the National Enterprise Credit Information Publicity System.

Finally, respective lists with all distrusted market subjects are published on CreditChina.gov.cn.

However, in light of the exceptional context of COVID-19, the Chinese authorities have promulgated preferential policies nationwide to lighten the burden of enterprises. As a result, in some cities for instance, enterprises are allowed to delay the payment of social insurance premium and housing fund without negative records of their social credit.

That being said, it is worth noting that currently the updates regarding the publication of the ratings are usually made every year while blacklisted and distrusted enterprises lists are updated and published on a monthly or quarterly basis.

Further, as data transfers, exchanges of ratings between governmental authorities and data publication are still not fully operational, the sanctioning mechanisms under the Corporate SCS are so far not fully implemented yet. In addition, there are disparities in implementation progress depending on governmental authorities and on the industry sector.

CREDIT RESTORATION AND REMEDIES

Companies (save for some companies which have been blacklisted when public safety is harmed or serious crimes are committed) will be able to restore their negative credit and stop its publicity online under certain conditions.

However, usually, the credit restoration can be applied for only after a minimum publicity period which can last anywhere from 3 months to 5 years, depending on the type of rating entry.

As for companies which are punished under the 'joint sanctions' mechanisms, which qualify as administrative penalties, they can file for objection, repeal, administrative reconsideration or administrative litigation.

Given a proper roll out, 2014 SCS is in theory a very ambitious plan which is supposed to be fully functional by end of 2020[2] .

[2] *Although one should anticipate that the work of governmental officials on the SCS could be slowed down by the COVID-19, hence potentially resulting in significant delays.*

However, China notoriously lacks consistency, coordination and comprehensiveness when designing and implementing reforms: just for the Corporate SCS, more than 1,500 government documents have been so far published by central- and local- level authorities while the responsibility for implementing the system involves more than 30 governmental authorities coordinated by the NDRC and the People's Bank of China.

Further, as of late 2019, the IT backbone of the Corporate SCS is far from being operational as there seems to be major issues relating to data formatting, standards and interoperability even though the new meta database system called National 'Internet+ Monitoring' System is currently being built.

Feeding the Corporate SCS with data from public entities and private companies hence represents a major challenge from a technical standpoint (not to mention rumors of reluctance of certain companies and security agencies to share their data).

Finally, the Corporate SCS (and the SCS in general) raises major concerns insofar as people and companies are data-mined most of the time without knowing it or without giving consent and as the gathering of so many data in a few databases and ultimately one centralized data infrastructure poses huge security threats.

The government has notably increased its activities (including legislative and regulatory agendas) during the second semester of 2019 not only to deploy resources and means to implement the SCS in 2020 but also to address public opinion concerns over personal privacy matters and improve cyber security.

Therefore, even though the roll out of the Corporate SCS is and will be complex and difficult with many hurdles to overcome thus probably delaying the full functionality of this ambitious system, latest signs reveal an unfailing willingness of the Chinese government to achieve its plan.

In such context, considering the significant consequences negative ratings and blacklisting have on a company's ability to conduct business in China and the difficulties and timeline to restore its credit once a company is deemed 'untrustworthy' (if ever possible in practice), companies should take advantage of the Corporate SCS not being fully functional yet, to assess their level of risk.

To this end, companies should identify, amongst the provisions scattered across thousands of documents, what the Corporate SCS exactly requires from the company, to assess where it stands in terms of fulfillment / compliance with the requirements and finally design and implement remedies and adjustments before it is too late.

For any additional information please contact:

Zhang Beibei : Associate
beibeiZHANG@dsavocats.com

Hou Yi-Ta : Counsel
hou@DSAVOCATS.COM

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