

China Insight



Corporate Social Credit System in China

Top 20 FAQ

Dear Sir or Madam,

Please find below an update of the regulatory situation and development of China's Corporate Social Credit System.

Kind regards,
CMS, China

The following shows a selection of frequently answered questions in conjunction with China's Corporate Social Credit System ("CSCS") and reflects the most recent regulatory developments until January 2023.

Regulatory Purpose of CSCS

Q1: What is the regulatory purpose of China's Corporate Social Credit System?

A1: The regulatory purpose of CSCS is to incentivize those companies, which are compliant with Chinese laws and to punish those, which are not compliant. The Chinese regulator has developed various tools for punishing and awarding certain conducts of companies doing business in China. Most significant for companies are the CSCS ratings. CSCS provides a number of specific ratings in specific areas (e.g. tax, customs and environmental). The ratings results, which are often based on scores, provide regulatory and business related positive and negative impacts on the individual company. High CSCS ratings can trigger advantages for the company, such as the accelerated process for approvals from authorities, easier access to get loans from banks and easier access to acquire land-use rights from the Chinese government. Low CSCS ratings can trigger disadvantages on the company, such as the restricted issuance of governmental approvals and increased inspection rates by authorities on the company's operation. Further, companies may be added under certain requirements on the positive redlist, close-watch list or on the negative blacklist in specific areas by different authorities. In addition to the CSCS ratings, companies may be subject to CSCS disciplinary actions. CSCS disciplinary actions shall be imposed on those companies, which have been involved in certain misconducts as compiled in a specific list by the Chinese regulator. Disciplinary actions include for example restrictions on participation in bidding and government procurement activities and the ban on entering certain markets and industry sectors.

Q2: Does CSCS provide a "unified total rating" or "unified total score" for each company in China?

A2: A "unified total rating" or "unified total score" for each company in China is currently not provided under CSCS. However, it is to be expected that the Chinese regulator will develop a system of a unified rating and unified scoring at a later stage. CSCS provides currently specific ratings and scorings for specific areas. For example, for environmental CSCS provides for a 4-level rating system (green card - blue card - yellow card - red card), which is linked to certain scores. For tax a 5-level rating system (A - B - M - C - D) is provided,

which is also linked to certain scores.

Regulatory Development of CSCS

Q3: Which authorities are driving the regulatory development of CSCS?

A3: Key drivers for the regulatory development of CSCS are the National Development and Reform Commission ("**NDRC**") and the People's Bank of China ("**PBOC**"). However, there are another 40+ authorities and organizations involved in the regulatory development of CSCS, which reflects the complexity of CSCS and the need for internal coordination among the involved authorities and organizations.

Q4: What are the most recent regulatory developments in relation to CSCS?

A4: NDRC has issued on 14 November 2022 the "*Law of the PRC on the Development of the Social Credit System (Draft)*" ("**Draft CSCS Law**") for public comments to be given until 14 December 2022. It remains to be seen to which extent the public comments, which have not yet been made available, will impact the current Draft CSCS Law and when it will be issued and become effective. Further, the "*National Basic List of Disciplinary Measures for Violations of Trust (2022 Edition)*" ("**List of Disciplinary Measures**"), which has been issued on 28 December 2022 jointly by the NDRC and PBOC, became effective on 1 January 2023.

Q5: What is the key content of the Draft CSCS Law?

A5: The Draft CSCS Law provides guidance to the authorities and organizations in China, which are operating and executing CSCS.

The Draft CSCS Law provides a number of rather general inter-administrative and political statements. See for example Article 1 and Article 10 of the Draft CSCS Law.

- Article 1: "*This law is formulated so as to improve the social credit system, innovate mechanisms for societal governance, optimize the business environment, standardize order in the socialist market economy, raise the entire society's awareness of creditworthiness, advocate the core socialist values, and complete a credit reporting system that covers the entire society.*"
- Article 10: "*Within the scope of their legally-prescribed authority, state organs and organizations authorized by laws or regulations to have public affairs management duties shall carry out punishments for entities with untrustworthy conduct.*"

The Draft CSCS Law also provides guidance to the authorities and organizations for the operation of CSCS, which is reflected for example in the following provisions:

- The Draft CSCS Law provides clarification of the precise content of the Credit Report (see Articles 65 and 66). The Credit Report may be generated from the website of Credit China at www.creditchina.gov.cn, which is the key database of CSCS and accessible in public. The Draft CSCS Law clarifies that only the information from those databases, which are listed in the *National Basic Catalog of Public Credit Information* may be added in the Credit Report.
- The Draft CSCS Law provides that the collection and operation of the data, i.e. of the credit information for CSCS, must strictly follow PRC laws and regulations, and that certain conducts are forbidden. For example, the Draft CSCS Law (see Article 62) emphasizes that credit information may not be stolen, fabricated or improperly deleted, and that credit information may not be leaked, if there is no authorization for disclosure.
- As a rule of thumb the Draft CSCS Law provides that the credit information of the involved companies, which refers to decisions or judgements of PRC administrative or PRC judicial organs shall be stored for five years from the date on which the administrative or judicial organ made the decision or judgement (see Article 63).
- The Draft CSCS Law (see especially Articles 101 to 109) provides fines under certain requirements on those PRC governmental officials, who are breaching their obligations under this Draft CSCS Law. Fines may be up to RMB 10 million.

However, the Draft CSCS Law does not provide any provisions for the unification of the system of ratings and scoring, which shall apply to companies doing business in China. The Draft CSCS Law is rather an internal inter-administrative guidance for the operation of CSCS.

Q6: What is the key content of the List of Disciplinary Measures?

A6: The List of Disciplinary Measures (40 pages) shows all those misconducts, which shall trigger disciplinary measures ("**Disciplinary Measures**").

The regulatory basis of the Disciplinary Measures is stated in those legal sources (e.g. laws, regulations, administrative documents and guiding opinions), where the breach of a specific provision under such legal source constitutes the misconduct. Therefore, the List of Disciplinary Measures is compiling (the already existing) Disciplinary Measures, which shall be triggered due to certain misconducts.

According to the List of Disciplinary Measures, the Disciplinary Measures include the following:

- Centralized public disclosure of the bad credit activities;
- Being put on key supervision;
- Restrictions on financial fund, policy preferences or facilitation measures, evaluation of priorities and merits;
- Being included into the list of serious breach of trust subjects;
- Being imposed with market entry or industry entry ban; and
- Restriction on participation in bidding and government procurement activities.

See the following examples.

Target of Disciplinary Action	Regulatory Basis	Disciplinary Action
The "Target of Disciplinary Action" is stated in the List of Disciplinary Measures (see page 4) as follows: <i>"Bidders who collude in bidding or seek to win a tender by means of bribery, and the circumstances are serious; bidders who bid in the name of others or cheat to win a tender by other means, and the circumstances are serious; successful bidders who do not perform their obligations in accordance with the contract entered into with the tenderer, and the circumstances are serious; [...]"</i>	Articles 53, 54 and 60 of the PRC Bidding Law, Articles 67 and 68 of the Regulations on the Implementation of the PRC Bidding Law	Disqualification from bidding on projects that must be tendered in accordance with the law for a certain period of time.
The "Target of Disciplinary Action" is stated in the List of Disciplinary Measures (see page 5) as follows: <i>"Export operators which have been imposed with penalties due to breaches of the Export Control Law"</i>	Article 39 of the PRC Export Control Law	Disqualification from applying for export licenses in accordance with the law for a certain period of time.
The "Target of Disciplinary Action" is stated in the List of Disciplinary Measures (see page 28) as follows: <i>"Market entities that have been included into the list of serious breach of trust in accordance with laws and regulations"</i>	Article 48 of the PRC Regulations on Safeguarding the Payment of Wages to Migrant Workers, the Guiding Opinions of the State Council on Establishing and Improving the System of Joint Incentives for Credit Keeping and Joint Discipline for Credit Loss to Accelerate the Construction of	Restriction from applying for financial funding.

	Social Integrity (Guo Fa [2016] No. 33), the Opinions of the General Office of the State Council on Using Big Data to Strengthen Services and Supervision of Market Subjects (Guo Ban Fa [2015] No. 51), the General Office of the State Council on Accelerating the Promotion of Social Credit System Construction to Build a Credit-based New Regulatory Mechanism (Guo Fa Ban [2019] No. 35)	
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Q7: Is the regulatory development of CSCS completed?

A7: The regulatory development of CSCS is still ongoing. Additional laws and regulations both on the national and provincial level are to be expected.

Q8: Is the collection of the relevant data for CSCS, i.e. of the credit information, completed?

A8: Given that every day new data will be released (e.g. through decisions from PRC authorities) the collection and synchronization of the CSCS related data is an ongoing process.

Blacklistings and Redlistings

Q9: Which kind of ratings and listings are provided under CSCS?

A9: CSCS provides for certain matters specific ratings on companies. See the following examples for tax and customs. For tax, companies will be subject to the following rating: A-B-M-C-D, where A is the highest and D the lowest rating. For customs, companies will be subject to the following rating: "*rated certified company*" (which is the highest rating), "*general-credit company*" and "*discredited company*" (which is the lowest rating). It shall be noted that currently not all conducts or misconducts of a company are subject to a rating. However, this could be changed given to the ongoing regulatory development of CSCS.

Further, CSCS provides three kinds of listings, where companies shall be added under certain requirements. The positive list is called "*redlist*" and the negative list "*blacklist*". Further, a "*close-watch list*" does exist. In practice, authorities are using different terms for the aforementioned lists, such as the "*List for Trustworthy Conducts*", which is the "*redlist*" and the "*List for Untrustworthy Conducts*", which is the "*blacklist*".

Q10: Which authorities are in charge for determining whether a company shall be added on the redlist, close-watch list or blacklist?

A10: CSCS provides that it is not always the same authority, which determines whether a company shall be added on the redlist, close-watch list or blacklist. The current mechanism of CSCS provides that the State departments at and above the county level and organizations with functions of administering public affairs (as authorized by the laws and regulations) shall determine whether a company shall be added on one of the lists or not. Further, certain departments of the State are entitled to authorize under certain requirements other organizations, such as the Chinese national industry associations and Chinese chambers of commerce to do so.

Q11: Which level of blacklistings exist under CSCS and what are the differences?

A11: CSCS provides for three levels of blacklistings, which are categorized by the level of severity of the company's misconduct. These blacklisting levels have been abbreviated in this document as "**Level 1 Blacklisting**", "**Level 2 Blacklisting**" and "**Level 3 Blacklisting**". The primary legal source of these blacklisting levels is the *Notice on Further Improving the Credit Repair Mechanism of Administrative Punishment Information on the "Credit China" Website and Local Credit Portal Websites ("Notice")*, which has been issued by NDRC on 30 April 2019 and became effective on 1 July 2019. The Notice provides a list of the misconducts, which shall trigger one of the 3 blacklistings.

- Level 1 Blacklistings are the most severe blacklistings. Level 1 Blacklistings provide for a publicity period of the blacklisting record of 3 years. The removal of the blacklisting record before expiration of this publicity period is not possible.

- Level 2 Blacklistings are less severe than the Level 1 Blacklistings. Level 2 Blacklistings provide for a publicity period of the blacklisting record from at least 6 months to 3 years. The removal of the blacklisting record before expiration of this publicity period is under certain legal requirements possible.
- Level 3 Blacklistings are less severe than the Level 1 and Level 2 Blacklistings. Level 3 Blacklistings provide for a publicity period from at least 3 months to 1 year. The removal of the blacklisting record before expiration of this publicity period is under certain legal requirements possible.

Q12: Can the blacklisting be offset with the redlisting? Is there a possibility to “heal” blacklistings with redlistings?

A12: No. On the contrary, once a company got blacklisted at CSCS, such company shall be removed from any redlistings. Example: The company ABC is a redlisted company by the tax authority, and got then blacklisted by customs. The redlisting record of company ABC shall be removed.

Q13: What is the impact of a blacklisting record on the blacklisted company?

A13: Blacklistings provide a number of negative impacts on the blacklisted company. There is a risk, that the blacklisted company could lose customers, if customers are not willing to maintain the business due to reputational considerations. This is not a specific CSCS related risk, but in fact existing, once a company got blacklisted under CSCS.

Further, CSCS provides specific blacklisted related negative impacts, which include for example the restricted issuance of approvals by authorities, more inspection rates by authorities and the prohibition to participate in government procurement activities. Additional regulatory disadvantages exist.

Q14: Does the blacklisting trigger the prohibition to manufacture or to sell as legal consequence of such blacklisting?

A14: Whether or not specifically the blacklisting under CSCS could trigger as legal consequence of such blacklisting the prohibition to manufacture or to sell must be assessed for the individual scenario. It will be important to consider also the local and industry-specific laws, regulations, rules and norms as well as company policies and the agreements of the involved parties, in order to clarify the legal situation.

Q15: Is there a prohibition to do business with CSCS-blacklisted companies (e.g. with suppliers and distributors)?

A15: Whether or not such prohibition exists must be assessed for the individual scenario. It will be important to consider also the local and industry-specific laws, regulations, rules and norms as well as company policies and the agreements of the involved parties, in order to clarify the legal situation. If no prohibition exists to do business with the CSCS-blacklisted business partners reputational criteria are getting likely more important.

Q16: Is there a possibility to object against the blacklisting record?

A16: Yes, a company may file an objection to the competent authority through Credit China or to the authority which made the decision.

If the objection has been filed to Credit China, the competent authority, through Credit China, shall review the objection to a limited extent only, which includes to review whether the record has any error, omission, expired, or is inconsistent with the decision of the relevant authority.

If the objection has been filed to the authority, which has made the decision, the authority shall conduct a substantial review. For instance, a company in China, which has been blacklisted by the Market Supervision Administration (“MSA”) may file an objection within 30 days after being blacklisted. The MSA shall decide within 5 working days on whether to accept the objection.

Q17: Is the company entitled to apply for the removal of the blacklisting record?

A17: That depends on the blacklisting level.

Level 1 Blacklistings may not be removed before the expiration of the publicity period of the blacklisting. That means, that the blacklisting record will remain for 3 years.

Level 2 Blacklistings may be removed before the expiration of the publicity period, if approved by the competent local credit authority (“**Local Credit Authority**”). The approval by the Local Credit Authority shall

require that the following conditions have been fulfilled: (1) Commitment Letter, (2) Registration Certificate, (3) Certificate for Fulfilment of Sanctions, (4) Evidence of Participating in Credit Training and (5) Credit Report.

Level 3 Blacklistings may be removed before the expiration of the publicity period, if approved by the Local Credit Authority. The approval by the Local Credit Authority shall require that the following conditions have been fulfilled: (1) Commitment Letter, (2) Registration Certificate, (3) Certificate for Fulfilment of Sanctions and (4) Credit Repair Form for Level 3 Blacklisting issued by the involved authority (if any).

Q18: Under which requirements companies shall be redlisted at CSCS?

A18: That depends on the involved matter. See tax and customs for example. The tax authorities' evaluation indicators include tax-related declaration information, tax payment information, invoices and tax control equipment information, registration and accounts books information, tax bureau's record of tax assessment, tax audit, anti-tax avoidance investigation and other criteria. For customs, the evaluation indicators include error rate for customs declaration, whether a company has established internal training systems, accurate books and records, internal audit control and other criteria.

Q19: What is the regulatory impact of the redlisting on the redlisted company?

A19: Redlisted companies may get regulatory advantages, such as for example the accelerated process for approvals from authorities, easier access to get loans from banks and easier access to acquire land-use rights from the government.

Conclusions

Q20: What are the strategies for making the business risk-proof in the world of CSCS?

A20: That will depend on the individual risk profile of the involved company. However, the following three conclusions will be likely important.

- **Risk Management Strategy:** Companies doing business in China need to understand first the mechanism and regulatory playbook of CSCS, in order to develop a solid risk management strategy. Focus of the risk management strategy will be likely to identify and avoid the specific CSCS related risks (e.g. blacklistings) and to "protect" the existing positive redlistings. That approach could be a significant challenge for those foreign headquarters, who have a weak control over their businesses and specifically subsidiaries in China.
- **Blacklisted Business Partners:** Business partners, which got blacklisted under CSCS, will trigger significant challenges. Compliance and risk management professionals must find an answer whether business with blacklisted business partners may be kept or must be terminated, and which legal and rating related risks could arise in conjunction with blacklisted business partners. Important parameter will include the applicable laws and regulations, the agreements of the involved companies and the company rules (including the Code of Conduct).
- **Defending Corporate Reputation:** CSCS will also have a significant impact on the company's reputation management. The data of CSCS, including the names of the blacklisted companies, is publicly accessible online. Blacklisted companies need also to anticipate that anonymous whistleblower may use the CSCS database as new tool for their allegations against the company. That could significantly damage the corporate reputation of the company. Therefore, executives need to anticipate these reputational risks and develop a crisis management strategy, in order to be well prepared if such reputation crisis arises.

DISCLAIMER: This document is a general introduction of CSCS only. All matters under this document have been presented in a simplified way and may not be complete. Local and industry-specific laws, regulations, rules or norms are not reflected in this document. It is possible that local or industry-specific laws, regulations, rules and norms could deviate from the content of this document. Given that the regulatory development of CSCS is still ongoing, amendments of the current existing legal and tax framework in relation to CSCS are to be expected in the future. This document does not intend to provide legal or tax advice. We recommend taking legal and tax advice for all matters under this document.

In case you have questions or for further information, please contact the authors of this newsletter:



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