



How is the Coronavirus Outbreak Shaping Up the Present and Future of China's Corporate Social Credit Score?

Leaf Law Firm
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Who Are We ?



A corporate law firm specialized in operations in China

We are corporate lawyers based in China. Our firm has been licensed by the Ministry of Justice. Our team is composed of Chinese and internationally qualified attorneys.

Our experience allows us to fully understand the legal implications and risks of doing business in China.

Our methodology implies that we work in bi-cultural team to provide efficient solutions to navigate through the complex legal environment around the world.

Local approach with international standards

Each member of our team has been trained in international law firms and is familiar with cross-border transactions.

Our true added-value is to manage complex transactions in a changing legal and business environment.

Our skills meet your needs

We have the experience of your case. We pride ourselves of having a creative approach to solve your problems in China with a “boutique” spirit.

We are solution driven and entrepreneurs.

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What is Corporate Social Credit Score?

Ratings Centralized in Credit System

The CSCS system was established in 2014 to match FICO score in the USA.

Rapid development under background of universal credit tendency in China

Many attempts to put in place personal credit score system

Almost all areas of corporate and individual activities have been gradually included in the system

Ratings Centralized in Credit System

30+ authorities

- Sector CSCS rules are regulated by various authorities
- Collective MoU for punitive measures /incentives
- Score in one sector may influence those in other sectors

Decentralized Ratings

- CSCS highly relies on local rules / procedures
- 0-1000; or
- A to D; or
- Color label; or
- Blacklist and Red-list

Credit Platforms

- Credit China
- Business Administration Website
- Various authority official websites

Global Rating

- One score for each company combing all sectors
- Algorithm not published yet

Punitive Measures for Non-Compliance

General Principle

“whoever violates the rules somewhere shall be restricted everywhere”

Regulatory

- Combination of “random inspection regimes” – higher frequency of inspection for companies with negative scores
- Punitive measures in stock issuance, bidding, financial subsidy, tax benefits

Industrial

- Suspension/removal of various license
- Key Personnel restricted from taking high-speed railway, extravagant consumption

Societal

Public announcement of and access to the blacklisted companies and its Key Personnel

Incentives for Good Grade

Highest grade may allow the company to enjoy the benefits in following areas:

Reputation

- Honored with certificate
- Introduced to public through credit platforms as best practices

Business Administration

- Green channels
- Reduction of frequencies of random inspections

Public Service

- Priority in government purchase projects
- Advantages in areas such as education, social insurance etc

Market Transaction

- Encourage financial institutions to provide financial incentives to Grade A cos (loans, etc.)

Main Outstanding Issues

There are still many aspects of CSCS system remain outstanding and pending for further clarifications from local governments.

Issue 1

Overall Rating

Still unclear how the overarching rating mechanisms works to calculate the total enterprise score in the end or how to articulate local and national calculations

Issue 2

Business Partner

Still unclear how the business partners' rating may impact of the company and the definition for such business partner

Foreign Companies under CSCS

General Principle

CSCS system is **NOT** targeting only foreign companies as has been circulated around.

Same rules apply to all types of companies, whether domestic or foreign.

In practice, evaluation procedures may create some **challenges** for foreign companies.

Foreign companies have culture of corporate compliance inherited from foreign local regulations (FCPA rules / UK anti bribery law/Loi Sapin 2, etc).

Challenge for Foreign Companies

Local Bureaucracy – Communication Cost

CSCS shall be a compliance issue. One issue to deal with is the impact of local regulations and implementation from local administrative authorities.

As a start, you don't know who you shall talk to

Some officials may be reluctant to give answers on phone

Still a system under construction with uncertainties

Officials do not use emails – official communication tools can be QQ

Bargaining space for evaluations – rules under construction

Opportunities for Foreign Companies

Better Compliance

Based on our experience, foreign companies are more sensitive than domestic companies on the impacts of CSCS

Compliance of foreign companies may be more compliance as it involves more authorities

Large multi-national enterprise tend to have appropriate internal compliance rules

Example – flexible working time filing – most domestic companies will not register for it

X-factor



Instrumentalization of CSCS?

Is it going to be a tool for CCP and local administrations to advance their agenda with foreign companies?

Request for local representation of communist party?

Apps to study thoughts of leadership?

Blackmailing?

Today: sharing of public record such as licences and other regulatory information as well as public court decisions/administrative sanctions



Outbreak of COVID-19 and Impact on CSCS

Current Situation of COVID-19

- **Globally**
 - Asia: Gradual containment of the situation
 - Middle East: Iran is a major topic of concern
 - Europe: It's becoming a next epidemic center
 - North America: various States have declared emergency status
- **In China**
 - Gradual containment of spread outside Hubei Province
 - Still large population under quarantine
 - Still restrictions over transportation/community
 - Major policy focus now: prevention of spread caused by imported confirmed cases

Impact on CSCS

General Principle

Delay/default caused by COVID-19 will not be recorded into CSCS

Shanghai	Beijing	Jiangsu Province
<p><i>“Due to the company’s participation in epidemic prevention work, discredit conducts such as delayed delivery and deferred repayment of loans etc., shall not be recorded as bad record.”</i></p>	<p><i>“The negative credit records of SMEs due to the epidemic situation shall not be included in the municipal public credit information system for the time being”</i></p>	<p><i>“For companies affected by the epidemic, credit repair mechanism shall be adopted to help companies reshape their credit and avoid the risk of untrustworthiness”</i></p>

Impact on CSCS

Not a Hall Pass

Violation of laws during epidemics may be recorded into credit management

Example 1 Illegal crimes such as driving up prices, manufacturing and selling fake and inferior medical equipment, etc

Example 2 Ministry of Human Resources and Social Security issued notice prohibits massive layoff during the epidemic

Example 3 Individual credit report of companies management member shall be supervised.

Example 4 Beijing: any untruthful declaration before entering China will be recorded into the credit management



Remediation scenarios - Case Studies

Scenario 1: Customized Audit



Case 1A: Environment CSCS in Gansu

Narrative:

To review Gansu's environmental CSCS regime for Client to design strategies.

Issue 1

Complex Local Regime

- “One evaluation, two results”
- Evaluating criteria initiated only for industrial companies – non-industrial companies have to negotiate with local ecological bureau to discuss the how the evaluation shall be conducted
- Some local authorities are reluctant to help

Case 1A: Environment CSCS in Gansu

Narrative:

To review Gansu's environmental CSCS regime for Client to design strategies.

Issue 2

Voluntary Regime – Self-evaluation

- Non-industrial companies are generally voluntary to apply for an environment rating
- Voluntary application may result in negative scores (it happens in practice)
- Access pros and cons for an application
- Self-evaluation is necessary before application

Case 1B: Global Tax CSCS System

Narrative:

To review the global tax rating systems, assess risks and develop mitigation plans for client.

Issue 1

Contamination Through Key Personnel

- Key Personnel: Legal Representative, Financial Manager and Tax-filing Person (“办税人”)
- **Key Personnel from Grade D legal entities will propagate the same grade to any legal entity in which they hold a similar role**
- By extension, it’s safe to anticipate all senior managers as Key Personnel in global CSCS rating system.

Case 1B: Global Tax CSCS System

Narrative:

To review the global tax rating systems, assess risks and develop mitigation plans for client.

Issue 2

Tax CSCS Repair and Improvement

- In practice, hard for companies to obtain Grade A – e.g. any failure of providing irregular information may result in Grade B
- Self-examination questionnaire is helpful
- Full knowledge of repair system allows company to remedy itself from negative score ASAP

Scenario 2: CSCS Due Diligence

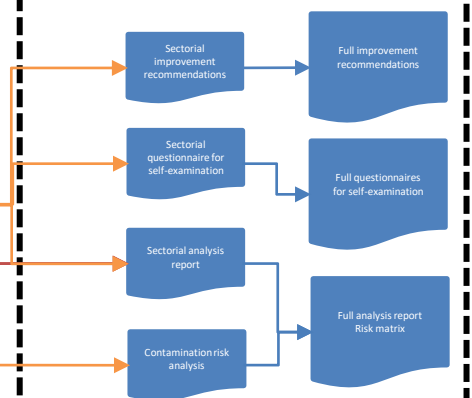
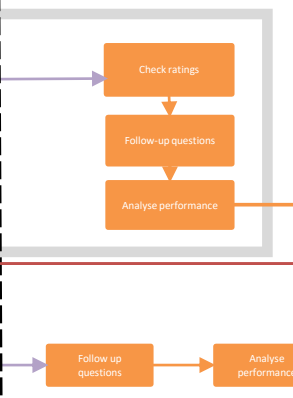
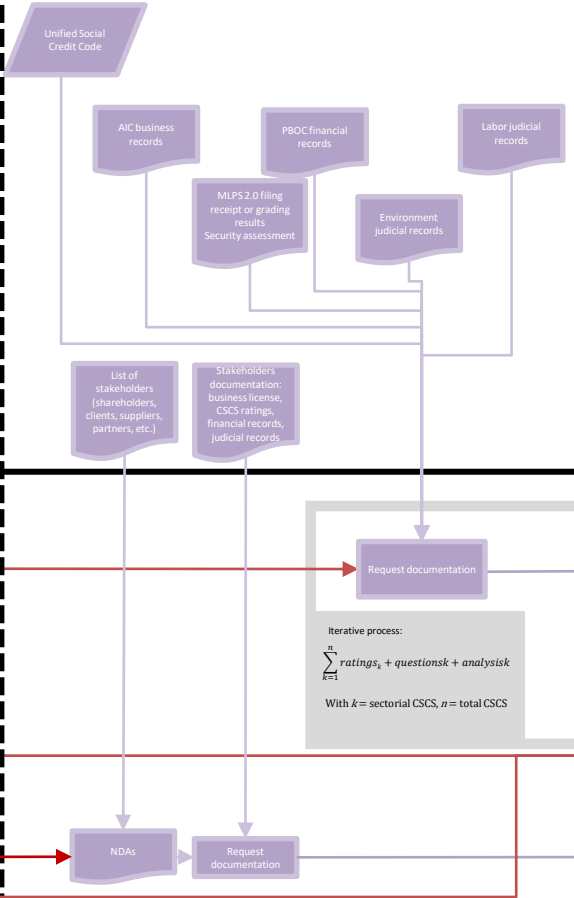
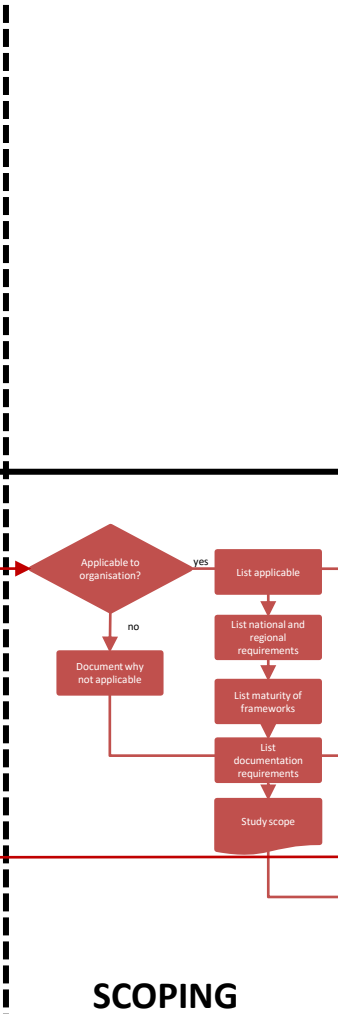
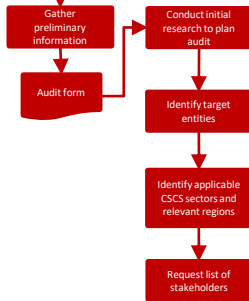


Case 2: Auditing Flowchart

Organisation



Audit or



PLANNING
1 week

SCOPING
1 week

DOCUMENTING
5 weeks

ANALYSING
2 weeks

COMPILING
2 weeks

PHASE 1

PHASE 2

Scenario 3: Customized Remediation Plans



Case 3A: Limitation of Legal Representative's Personal Liabilities

Narrative:

To review client's corporate governance structure in China and its risks under CSCS for its legal representative.

Issue 1

Mitigate Tax Contamination Risks through Key Personnel

- Changing the legal representative to respective CEO for WFOE
- Establish corporate management rules for company chops storage/use to exercise control

Case 3A: Limitation of Legal Representative's Personal Liabilities

Narrative:

To review client's corporate governance structure in China and its risks under CSCS for its legal representative.

Issue 2

Restructure Joint Venture's Corporate Governance

- Internal review of how business is practiced at each JV level
- Restructure the board size/member (in line with new Foreign Investment Law)
- Assign CSCS compliance duties to Chinese partner
- Regularly monitor the CSCS of its Chinese partner

Case 3B: Score Improvement

Narrative:

One of our client is labeled Blue in environmental CSCS in Jiangsu (Best grade is Green).

Issue 1

Identify the Problems

- Get full picture of the local regime
- Identify the reasons for a bad grade
- In this case, client received a fine from environmental bureau

Case 3B: Score Improvement

Narrative:

One of our client is labeled Blue in environmental CSCS in Jiangsu (Best grade is Green).

Issue 2

Find the Solutions for Score Improvement

- Identify the formal local repair system
- In this case, the deduction of points will be valid for 6 months
- Identify the department in charge of evaluation
- Talk to them for actions to take in practice



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Q&A Session



Thank You



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