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China's Social Credit System

How will it affect Polish enterprises in China?

The Social Credit System currently being rolled out in China may pose significant organisational and legal challenges for both foreign and Polish entities operating in China.

Polish enterprises should pay special attention to verifying their business partners in China, not only in examining the quality of goods they produce and their operational compliance with law, but also verifying their Social Credit System rating.

The ongoing implementation of the System gives Polish businesses time to adapt to the new requirements. Companies should review their current performance, identify risks and detect negative records before sanctions are implemented. They can also adjust their internal processes and structures to the requirements of corporate SCS to ensure they receive a positive rating in the future.

How does the Chinese Social Credit System work?

The Social Credit System is an initiative currently being implemented in China to monitor and assess citizens' behaviour in terms of compliance with law and the principles of social coexistence. The system is based on databases which include information from all kinds of state registers, courts, public administration bodies, traffic cams and mobile apps. It is designed to build a high-trust society where individuals and organisations follow law and closely adhere to the non-legal principles of social conduct.

This is achieved by assigning social credit scores to citizens based on their behaviour, directly translating into a variety of rewards and punishments. High scores give access to all kinds of public benefits, while low scores result in loss of social credit and, in consequence, hindered access to such benefits, housing or credit markets, and may even lead to restrictions on travel, including on leaving China.

The Social Credit System, which is being developed and refined, in addition to monitoring and assessing citizens' behaviour, also comprehensively covers business activity.

Participation in the system is mandatory for all businesses registered in China, both domestic and foreign, which are constantly monitored for compliance with law and the non-legal principles of social coexistence. It is crucial for businesses to understand the areas of compliance to avoid losing public trust and even being blacklisted.

Rating of businesses under the Social Credit System

The score depends on compliance with law, lack of tax arrears and implementation of government policies. The assessment also covers past projects, in particular those relating to the public sector, annual financial statements and reports, and business licenses, concern for the environment, compliance with employee rights, as well as online activity (primarily for e-commerce).

Low-scoring businesses that do not meet the requirements may be blacklisted, which could lead to restrictions on their current operations, including access to market capital, public procurement and public aid. Business partners of any such blacklisted company may also be affected, since maintaining business relations with a blacklisted company reduces the rating of its business partners.

At the present stage of implementation, the system is not yet unified, with individual public authorities keeping their own relevant business registers and ratings.

Pending full system consolidation and centralisation, "joint sanctions", imposed simultaneously on a single entity by several public authorities for illegal actions in more than one area, have been introduced as a temporary enforcement mechanism. Such sanctions may extend to a number of business areas.

In practice, a low score for late payment of taxes can result not only in tax sanctions, but can also limit the company's ability to obtain land use permits or rights.

The Social Credit System directly covers all businesses registered in China, both domestic and foreign, but may indirectly impact all enterprises doing business in China insofar as their business partners in China will be covered by the system.

Polish firms having their representative office, branch or daughter company in China will be directly covered by the system and must ensure that its activities comply with the system requirements, since the activity of that company will be assessed under the system, resulting in facilitated or restricted access to the Chinese market as discussed above.

Polish businesses importing goods without a permanent presence in China will be indirectly covered by the system, i.e. through their Chinese suppliers, meaning that the positive or negative rating of suppliers will also affect the Polish company's subsequent rating (should it opt to establish a presence in China in the future).

Since the Social Credit System is still being developed, it is not yet clear what requirements it will impose on technology sector players, particularly with respect to the obligation to submit user data to state registers. This may be particularly difficult for IT, gaming and technology service providers that manage large amounts of sensitive data concerning their users, often including consumer behaviour.

Key issues to be considered

The Corporate Social Credit System will have a profound impact on the operation and development of companies doing business in China. Therefore, at this stage, it is important for companies to identify their obligations related to the System being introduced and prepare accordingly for its implementation. Below are some of the key steps:

1. Identifying the regulatory framework in the area/sector where the company operates – as the system is not yet uniform at the national level, regulations affecting the system rating of companies may differ depending on the province, city, or industry in which the company operates (e.g. expectations for the pharmaceutical industry may differ from those of the food industry). In addition to the regulatory framework, it is also important to understand the actual expectations of public authorities towards companies active in the area/sector for which the authorities are responsible;

2. Verifying business partners – it is crucial to identify the rating of Chinese business partners as working with lower-rated companies lowers the rating of their business partners;

3. Carrying out an internal audit – verifying information to be provided to the authorities for full compliance with the law. This means that companies need to ensure that their internal processes and structures enable the effective management of the System and prevent negative ratings and sanctions. At this stage, it is essential to understand what exactly the Social Credit System requires of the company and assess the level of implementation of the relevant compliance procedures;

4. Implementing appropriate procedures – if the audit reveals that the company's procedures are insufficient, procedures should be put in place to ensure compliance with System requirements;

5. Implementing a corrective plan (optional) – if a company receives a low rating in the Social Credit System, it can implement a corrective plan to improve it. For example, in the tax system, companies may receive either a rating of A, B, M, C or D, with A being the highest score.

If a company receives a B rating, e.g. due to late payment of taxes (and consequently loses their eligibility for state aid), it may raise its rating by improving the timeliness of filing future financial statements or, in the case of errors in tax returns, by correcting financial statements in the future with the help of specialised tax offices. It takes 1-3 months to raise a company's rating. However, if a company is blacklisted, it may take 2-5 years for it to be removed from the list.

Perspectives

Recently, several Chinese technology giants, including Huawei, Alibaba, Tencent, VisionVera and Taiji Computer Corporation, have also been involved in the work to create a single central database for the system.

Kochański & Partners China Desk

The dedicated China Desk team have extensive experience serving Chinese entities in the Polish market and Polish entities in China, in areas as diverse as energy, transport, pharmaceutics and new technologies. Our specialists are all dual graduates of both Asian and Polish Universities, well-versed in Chinese business etiquette. Understanding of Chinese business and legal culture allows our Chinese clients to trust us to support them at every stage of their entrepreneurial activity, offering solutions tailored to their business needs and expectations.

The team actively participates in all major China-related economic events, and can comprehensively, professionally and individually advise clients in all areas of doing business both in Poland and China.

China's Social Credit System – how can we assist?

We assist our clients at every system implementation stage. Our experience and cooperation with renowned Chinese law firms allow us to provide advisory in the following areas:

Company profile overviews

It is crucial for foreign-invested enterprises to have a thorough understanding of compliance requirements and the legal position of their Chinese subsidiary. Based on available ratings and blacklists, we provide a comprehensive review of the social rating of a company incorporated in China, including any potential compliance risks or irregularities.

Company financial overviews

We specialise in reviewing accounting records and internal financial processes to identify potential risks and compliance issues that have a direct impact on a company's credibility rating. This review allows greater transparency and enables continued compliance with regulations.

Company rating improvements

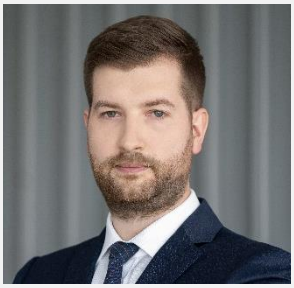
Our team helps low-scoring or blacklisted companies rectify outstanding compliance issues, and supports them in applying to the relevant authorities to improve the rating.

Jacek Kozikowski, PhD, LL.M. is responsible for the Firm's relations with Chinese clients. Jacek advises on energy & infrastructure projects with a particular focus on greenfield investments, and energy, transport and pharmaceutical projects for Chinese businesses in Poland. Prior to joining Kochański & Partners, Jacek spent several years in Asia and was awarded his PhD degree in International Investment Law from Nagoya University, Japan.

Aleksandra Ryżkowska, LL.M., specialises in delivering business advisory to Chinese and Polish operators. She holds a Master of Law degree in Chinese Comparative Law from China University of Political Science and Law, Beijing. Prior to joining Kochański & Partners, Aleksandra worked at one of Poland's largest law firms. During her 2-year stay in China, she also gained professional experience as an intern at the Embassy of the Republic of Poland in Beijing, where she was responsible for Polish-Chinese economic cooperation.

Patrycja Pendrakowska, President and Founder of the Boym Institute think tank, and PhD student at the Faculty of Philosophy, University of Warsaw. A sinology, sociology, philosophy and financial law graduate of the University of Warsaw, having also studied at LMU in Munich and FU in Berlin, completing her research internship at the Chinese Academy of Social Sciences, Beijing. Her scientific focus includes political, ideological, economic and legal transformation in the People's Republic of China.

Contact us



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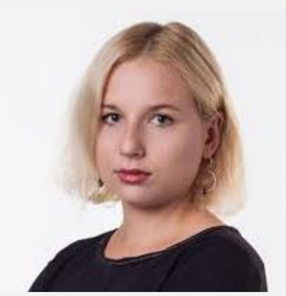

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