# A tale of two visions: what does China's social credit system really mean?

May 2019

Hogan
Lovells

# A tale of two visions: what does China's social credit system really mean?

## 1. What is China's social credit system? - Definition

The Social Credit System (社会信用体系 in Chinese "**SCS**") in the People's Republic of China ("**PRC**" or "**China**")[1] is not a brand new concept. Starting from the early 2000s, some pilot provinces and cities started developing social credit systems to rate individuals and enterprises. The concept was refreshed when the *Outline Plan for Construction of a Social Credit System (2014-2020)* (the "**Outline Plan**") was issued by the State Council on June 14, 2014, which states that fundamental laws, regulations and standard systems in relation to social credit and a credit reporting system with comprehensive coverage of society based on the sharing of credit information resources are targeted to be in place by 2020.

### 1.1 Social credit concept

The key to the definition of SCS is the "Social Credit" concept. Pursuant to local social credit regulations, Social Credit is defined as a subject's (*i.e.* a person or organization's) compliance status with respect to laws, regulations, and contractual obligations. [2] This definition might read like *legalese*, but it contains a critical pointer that the primary focus of Social Credit is compliance with legal obligations under pre-existing laws, thereby rooting the SCS in the current legal system.

The broad language contained in the Outline Plan, discussing the construction of a 'culture of creditworthiness' and 'moral education', led many to fear that social credit will regulate and restrict behavior beyond legal requirements in a construct which is a 1984-esque attempt to have government micro-manage every aspect of its citizens' (or foreigners who are subject to rating under the SCS) life. However it could be argued

that the primary goal of rolling out SCS is to add secondary penalties and enforcement mechanisms against those who have violated laws or failed to perform pre-existing legal obligations, rather than directly imposing new obligations. That being said, the understanding of 'credit' is still a broader concept than what may be familiar elsewhere. Credit usually refers to someone's financial creditworthiness, but the social credit apparatus also aims to assess 'reliability' going far beyond that. The basic premises of the Outline Plan can be summarized as follows:

(a) Aggregating and integrating information within and across geographic regions and specialised fields.

(b) Creating measures to incentivize 'trustworthy' conduct, and punish 'untrustworthy' conduct.

(c) Increasing reliance on credit evaluations in transactions, employment, and so forth.

(d) Using the above mechanisms and moral education to foster a trusting environment.

### 1.2 Classification of impacted groups

SCS is a big idea, and more of a policy or ideology governing data use than a single project or system. It impacts entities in all fields and individuals and, pursuant to the Outline Plan, can be broken down into the following four major groups, each with their own emphasis:

(a) Government Affairs: Emphasizing government transparency, public supervision to increase government integrity and fight corruption.

(b) Commercial enterprises: Primarily publishing records of

---

[1] For these purposes, excluding the Hong Kong and Macau Special Administrative Regions and Taiwan, where no equivalent SCS exists.

[2] See Article 8 of *Shanghai Municipal Social Credit Regulations*, effective 1 October, 2017.

corporate violations of existing industry regulations or laws to guide consumer reliance and enhance deterrence.

(c)     Social organizations and welfare: Emphasizing prevention of fraud, public use of credit.

(d)     Justice sector: Seeking to improve credibility by increasing transparency and taking a hard line on corruption.

Furthermore, the *Guidance Opinions on Strengthening the Establishment of the Personal Creditworthiness System* (国务院办公厅关于加强个人诚信体系建设的指导意见)[3] have been issued to establish an individual creditworthiness system, whereby a personal real-name registration system, personal creditworthiness record (in key fields such as food safety, financial services, e-commerce and so forth), long arm enforcement 'red' and 'black' lists (see more analysis on this under Section 3.1) and other strategies have been laid out for increasing individual social creditworthiness. For example, an individual who fails to pay taxes in a timely manner will be closely monitored by various governmental authorities, and punishments, such as a ban on leaving China, or restrictions on purchasing flight or train tickets may be imposed on him / her.

## 2.     What has happened so far? – Legal overview

### 2.1     SCS on National Level

On a national level, several core structural documents have been issued to form the roadmap for constructing SCS. The Outline Plan sets forth various construction targets for different industries, including the construction of credit information collecting and sharing

systems in the trading and commercial distribution industry that aim to monitor, supervise and manage enterprises based on their credit classification. The National Development and Reform Commission ("**NDRC**") and the People's Bank of China ("**PBOC**") have also released instructions and three-year main task guidance in relation to the Outline Plan in 2014, requesting competent regulatory departments in charge of industry sectors to develop a rating and credit reporting system in various sectors.

In addition to the major roadmap documents, the SCS has been slowly forming a subtext to a wide number of regulatory documents covering many fields. While these documents say little about the SCS directly, they often contain a seemingly throw-away clause noting that certain information should be included in a person or entity's social credit file. There have also been a number of industry-specific 'blacklists' created, restricting serious offenders from engaging in related fields—mainly in highly regulated industries that already require some form of regulatory approval or professional credentials, for example in the sports market, cultural sectors, telecommunications and so forth.

A non-exclusive list of industries and professions to which social credit measures will be applied in the early stages of the project has been selected, mainly covering the following areas:

| | |
|---|---|
| *Industries* | Food and drugs, production safety, fire safety, traffic safety, environmental protection, biological security, product quality, tax collection, health care, labor security, engineering and construction, financial services, intellectual property rights, judicial proceedings, e-commerce, and volunteering services. |

---

[3]     Issued by the General Office of the State Council on 23 December 2016, effective the same day.

| | |
|---|---|
| *Professions* | Officials, legal representatives and the relevant responsible persons for enterprises, lawyers, teachers, doctors, practicing pharmacists, appraisers, tax accountants, registered fire safety engineers, accountant audit personnel, real estate agents, certified personnel, financial professionals, and tour guides. |

## 2.2    SCS on the local level

Since the release of China's blueprint for establishing a SCS, four provincial-level governments have released comprehensive implementing regulations for their own local SCS schemes:[4]

- *Hubei Provincial Social Credit Information Management Regulations* effective 1 July 2017 ("**Hubei SC Regulations**");
- *Shanghai Municipal Social Credit Regulations* effective 1 October 2017 ("**Shanghai** SC **Regulations**");
- *Hebei Provincial Social Credit Information Regulations* effective 1 January 2018 ("**Hebei SC Regulations**"); and
- Zhejiang Provincial Regulations on the Management of Public Credit Information 1 January 2018 ("**Zhejiang SC Regulations**"),

together, the "**Regional SC Regulations**"

Based on the provisions in the above rules, social credit information can be further divided into (a) public credit information and (b) market credit information: [5]

*Public credit information* refers to information produced or acquired in the performance of government functions by state organs or legally authorized organizations. It includes things like fines, warnings, citations, punishments, court orders, and also professional qualifications, business licenses, official approvals, commendations and so forth.

*Market credit information* refers to information generated by businesses, organizations, or credit services and credit investigation bodies that might provide some insights into the subject's compliance with legal obligations. This could be raw information, or it could be a privately created 'score' or assessment generated in reliance on public or market credit information.

### (a)    Negative information included

Each of the Regional Regulations specifically identifies what negative information is to be included as part of a credit archive.[6] While the specific items to be included as negative entries vary somewhat from region to region, they all focus on compliance with laws and regulations, including where administrative action is taken against a business for violating industry-specific rules such as excessive polluting, violating health codes, or publishing prohibited material. This is consistent with the SCS's primary focus on enterprises rather than individuals, and its development through blacklists and credit systems targeting specific industries.

For example, under the Shanghai SC Regulations, the following negative information must be included as part of a credit archive:

(i)    Failure to pay taxes, social insurance premiums, administrative fees, and governmental funds that by law must be paid in a timely manner;

---

[4]    It is clear just from the names of the four Regional SC Regulations that their scope is somewhat different. The Shanghai SC Regulations are broadest in scope, dealing with social credit generally, followed by Hebei which limits the topic to 'social credit information', then Hubei's narrower 'information management' and Zhejiang's addressing only 'public credit information', while the others also consider 'market information'.

[5]    See Article 3 of Hubei SC Regulations, Article 8 of Shanghai SC Regulations, and Article 3 of Hebei SC Regulations.

[6]    See Article 10 of Hubei SC Regulations, Article 9 of Shanghai SC Regulations, Article 12 of Hebei SC Regulations and Article 11 of Zhejiang SC Regulations.

(ii) Providing false materials, concealing the true situation, infringing upon social management order and the public interest;

(iii) Refusing to enforce legal judgments;

If an enterprise fails to perform its obligations as specified in a judgment and takes further actions to evade enforcement, it will be listed on the "List of Dishonest Enforcees" and its enterprise name, legal representative, and specific circumstances of the dishonest acts will be further disclosed to the public.

(iv) Being issued with administrative punishment orders, except where the unlawful act of such enterprise is minor or proactively eliminated; or

(v) Being restricted from entering into a market by regulatory authorities.

### (b)    Punishments for untrustworthy behavior

In contrast to the 'scary' but pervasive image of China becoming a place where people and businesses are constantly rating each other (which many delivery and service apps do independently), the 'social' component of these SCS is largely about making 'credit' information publicly accessible and ubiquitous. Using public shaming and reputational loss as a means of enforcement in China are not new, but the Internet allows this to be stepped up a notch through public broadcasting and data integration and aggregation tools.

While a few rating systems used in some social credit pilots and commercial products have monopolized foreign media coverage, the heart of the system is less about assigning a 'score' than about creating a digital archive of an entity's performance in meeting its obligations. The systems are probably more akin to a virtual compliance record than to a traditional credit score. The issue is around what defines an 'untrustworthy' act: some are fairly obvious and

easy to identify, but this can easily slip over into subjective determinations of the nature of actions, based on political views.

In addition to being named and shamed, those who have negative credit histories are less likely to enjoy government benefits and more likely to face heightened scrutiny. The general consequences for having negative credit information include:[7]

(i) Inability to apply for simplified administrative procedures (and stricter review and examination requirements may apply);

(ii) Restrictions in applying for financial incentives;

(iii) Restrictions in enjoying certain facilitation measures in the course of being managed and monitored (which is, in essence, similar to (i) above, such as documentation and procedures for applying for governmental approval cannot be simplified);

(iv) Downgrading of credit scores and credit ratings in the trading of public resources; and

(v) Being blacklisted as key regulatory target in the day-to-day supervision, facing more frequent supervision and more frequent on-site inspections.

For example, if an enterprise has been on the List of Dishonest Enforcees, it will face credit disciplinary action in terms of government procurement, bidding and tenders, administrative examination and approval, government support, financing credits, market entry and qualification accreditation.

### (c)    Seriously untrustworthy list

In addition to the general consequences of having negative credit, with the exception of

---

[7]    See Article 28 of Hubei SC Regulations, Article 30 of Shanghai SC Regulations, Article 32 of Hebei SC Regulations and Article 23 of Zhejiang SC Regulations.

Hebei, the Regional SC Regulations further stipulate the 'List of the Seriously Untrustworthy', meriting heightened punishment when untrustworthy acts are serious to the extent of endangering others or the national interest, the criteria for which still remain unnervingly vague, despite definitions in the relevant Regional SC Regulations, although certain governmental departments have issued relevant rules to reflect the concept.

Taking annual reports as an example, an enterprise which has failed to file an annual report with the State Administration of Market and Regulation would be put on a list of "irregular businesses" and be further included in the list of seriously non-compliant enterprises if it has been on the list of "irregular businesses" for three consecutive years. Being on the list of the seriously untrustworthy will result in certain consequences, ranging from its business license being canceled, being banned from entering certain professions, to losing social benefits or worse.

## 3. What is the impact of SCS on foreign investors? – Impact analysis

Under the new *Foreign Investment Law* passed by the National People's Congress ("**NPC**") on 15 March 2019 (the "**FIL**"), which will become effective 1 January 2020, a foreign investor or foreign-invested enterprise shall be investigated and penalized for any acts in violation of laws or regulations and such misconduct shall be recorded in the credit information system in accordance with relevant provisions of the State.[8] Read together with the social credit regulations, foreign investors will, therefore, also fall under the jurisdiction of the SCS.

### 3.1 Long arm enforcement – 'red' and 'black' lists

One of the recurring themes of the emerging SCS is that credit scores under it should have far-reaching consequences, including both

rewards and punishments. The idea is that creditworthiness, a concept far wider and larger than traditional creditworthiness should not be compartmentalized, and that the 'untrustworthy' should be treated as such in all aspects of life. In practice this will mean making data available on centralized platforms, creating differentiated administrative treatment based on good and bad credit records, and encouraging broader society to rely on credit information in interpersonal dealings. It also means the philosophy is somewhat Manichean in its application. You are either in the 'good camp' or the 'bad camp', with little in between or the ability to argue that a 'failure' in one area of your life e.g. maintenance payments to an ex-spouse does not make you an overall 'bad person'. However, there is some scope to recover from a negative classification, as will be analysed below.

China has unveiled a series of interdepartmental agreements on joint enforcement of rewards and punishments for 'trustworthy' and 'untrustworthy' conduct in every area of life that is regulated by law e.g. public order on means of public transportation. The lists of targets for rewards are called 'red lists' and the lists of targets for punishments are called 'black lists'. [9]

These red and black lists are at the heart of China's emerging SCS. As noted above, despite its name, social credit is not really focused on scores *per se*, but more regulatory enforcement of existing laws. You could argue that it almost forces some regulatory agencies, whose record in law enforcement is rather patchy, to enforce laws because violators are literally pushed under their noses and 'on the record', so they can hardly claim ignorance.

Basically the idea is to:

---

8       Article 38 of the FIL.

9       See *Guiding Opinions on Strengthening and Regulating Efforts on the Management of Lists of Persons Receiving Joint Incentives for Trustworthiness or Joint Punishment for Untrustworthiness* (关于加强和规范守信联合激励和失信联合惩戒对象名单管理工作的指导意见), issued by the NDRC , PBOC, effective 30 October 2017.

1) Use real name registration systems (and unique organization ID numbers called unified social credit codes) to make sure that all conduct, whether by a person or an enterprise is traceable back to them.

2) Where laws and regulations or other legally binding requirements are violated, the non-compliant individual or enterprise may be put on a blacklist issued by the government agencies that enforce those laws.

   a. Regulatory and supervisory agencies publish standards for what violations of law will result in being on the blacklists.

   b. Violations that do not meet black listing criteria might still give rise to being on a non-public list for enhanced scrutiny and further being on a "Big Data Warning List", which will be available to the public if a non-compliant enterprise or individual has been on three or more key scrutiny lists (a variation of the 'three strikes and you are out' rule).

3) Pursuant to separate joint enforcement memorandums, various regulatory departments agree to take enforcement actions within their administrative powers against persons that other departments have blacklisted.

   a. Blacklists from each field are generally released to the public and other government agencies through the National Social Credit Information Sharing Platform.

   b. These enforcement mechanisms tend to be coercive, rather than punitive, meaning you can rectify your non-compliant acts.

   c. A joint enforcement memorandum for enforcing court judgment defaulters (失信被执行人) is probably the broadest reach in terms of enforcement actions.

## 3.2    Personal responsibility

Accountability reaching 'down to the individual' has been a persistent theme of SCS. Government officials, corporate executives, or ordinary citizens, are all to be held personally responsible for their own untrustworthy acts, as well as for those of entities over which they have control.

Under the *Guidance Opinions on Establishing and Enhancing the System of Joint Incentives for Trustworthiness or Joint Punishments for Untrustworthiness Systems and Accelerating Social Credit Construction* (国务院关于建立完善守信联合激励和失信联合惩戒制度加快推进社会诚信建设的指导意见) (the "**Joint Incentives Opinions**")[10], both entities and people in charge are held liable for serious untrustworthy conduct by entities. That means that foreign owners, controllers and legal representatives might be held responsible for misconduct by an enterprise.

## 3.3    Restoration of credit

Under the *Guidance Opinions on Strengthening and Regulating Efforts on the Management of Lists of Persons Receiving Joint Incentives for Trustworthiness or Joint Punishments for Untrustworthiness* (关于加强和规范守信联合激励和失信联合惩戒对象名单管理工作的指导意见)[11], paths to challenge negative scores or designations such as through administrative reconsideration procedures are mentioned. However we think the likelihood of challenges to a negative score or government designation being made at all is low, and the chances of a successful outcome even lower, as the evidential burden in 'proving a negative' is likely to be high. Some means by which the impact of credit defaults can be reduced and how bad credit might be repaired are also presented in the guidance, with the latter including performing

---

10    Issued by the State Council on 30 May 2016, effective the same day.
11    Issued by NDRC and PBOC on 30 October 2017, effective the same day.

voluntary services and making charitable donations. This may provide some balance to the rather 'black and white' nature of the classification touched on above.

| Minimizing negative credit impact | Repairing Credit |
|---|---|
| Performing obligations | Regularly performing obligations on time |
| Applying for extensions | Volunteering services |
| Offering explanations | Charitable donations |

## 4.  What will happen next? - Outlook

Based on the Outline Plan, the following, rather vague goals are due to be met by 2020:

1) Fundamental laws, regulations, and standards on social credit are essentially established;

2) A credit investigation system that covers all of society, and is built on sharing credit information resources is essentially formed;

3) Credit oversight systems are essentially complete;

4) The credit services market is doing well; and

5) Joint incentives and punishment mechanisms are fully effective.

The Outline Plan covers the years 2014-2020, and in all likelihood, we expect that a new plan will be released on completion of this one.

## 5.  Conclusion

There are two world views of the SCS, which paint diametrically opposed images.

The Chinese government view is that SCS is essentially building on the concepts going all the way back to public punishments in ancient times and up to the present day as a means of deterrence ('kill a chicken to scare a monkey'), and is a system of using incentives and punishments as a means of improving social order and encouraging good behaviour while reining in bad behaviour, with the challenge being how to control a large and diverse population scattered over a huge geographical area. The emphasis is on changing patterns of behaviour of the minority of violators and defaulters whose selfish or anti-social actions make things unpleasant for the vast majority, thereby providing a better business and personal environment to the law-abiding majority.

The view often portrayed in the Western media is that SCS is an Orwellian monster supported by big data analytics and intrusive monitoring and aggressive data collection practices (ten finger fingerprinting of foreigners at entry points into China as a condition for being let into China or using pop concerts as a venue for identifying criminals in the crowd using facial recognition software for example), which is coercive in nature (you cannot opt out), and the purpose of which is to allow the Chinese government to have so many data points on any individual that the individual's privacy is unacceptably compromised. The other concern that is often expressed in this context is that despite all the reassurances given and the punishments available under the law, the SCS is open to being used for political purposes, such as identifying dissidents. It is also true that in an environment like China where corruption is an issue, the 'country size' data lake that China is creating is vulnerable to abuse by insiders who can make large sums of money by selling or disclosing the same. It is, however, important to maintain a sense of proportion and objectivity here: the UK, for example, has a huge density of security cameras on its streets, the US, the EU and the UK take and keep copies of fingerprints at border entry points from foreigners (although not as many as China). Every government in the world collects data. No government in the world

is immune from data leaks. In the end it comes down to an assessment of the degree of trust each individual has in government in terms of how it will use the data collected and how robust and credible the safeguards against abuse are.

The truth probably lies somewhere in between the two images, with considerable uncertainty about how the Chinese government will in fact deploy the data set it has and continues to collect. It has, however, started to export the systems and software that lie behind SCS to other countries, which may in turn seek to use them in ways that may be a concern to visitors there. The combined effect of aggressive data collection and aggregation via multiple inputs such as through border controls (including facial recognition software), transportation hub and street surveillance cameras, or even through the mandatory transmissions back to the data centre by modules required to be installed in all electric cars in China is probably enough to make a majority of foreigners in China uncomfortable. They may feel powerless to protest or apply to amend any records held by the Chinese government, fearful their data may end up in the wrong hands and be used to spam them or sell them goods and services they do not want, or to allow the Chinese government to intrude into every corner of their lives in China.

For Chinese people, the fears may be somewhere along a scale of those felt by foreigners, with a particular concern over questionable data collection practices in China generally, although many of them will not have a comparator data point from experience living in other countries. They may be more alive to, and exposed to, the social issues that SCS is in part at least designed to address, such as bad behaviour by individuals and enterprises that impact on their daily lives in many ways. Hence they may be more willing to see the benefits that SCS can have in terms of putting pressure on bad actors like unreliable decoration companies or by banning seat squatters from public

transportation hubs, and to accept the Chinese government's public stance on SCS that it is a project that will bring tangible improvements to society as a whole, and less likely to accept the largely negative spin that the Western media has tended to put on the SCS.

## Contacts

**Andrew McGinty**
Partner, Hong Kong
andrew.mcginty@hoganlovells.com

**Jun Wei**
Partner, Beijing
jun.wei@hoganlovells.com

**Roy Zou**
Partner, Beijing
roy.zou@hoganlovells.com

**Adrian Emch**
Partner, Beijing
adrian.emch@hoganlovells.com

**Philip Cheng**
Partner, Shanghai
philip.cheng@hoganlovells.com

**Kate Chen**
Associate, Shanghai
kate.chen@hoganlovells.com

Alicante
Amsterdam
Baltimore
Beijing
Birmingham
Boston
Brussels
Budapest*
Colorado Springs
Denver
Dubai
Dusseldorf
Frankfurt
Hamburg
Hanoi
Ho Chi Minh City
Hong Kong
Houston
Jakarta*
Johannesburg
London
Los Angeles
Louisville
Luxembourg
Madrid
Mexico City
Miami
Milan
Minneapolis
Monterrey
Moscow
Munich
New York
Northern Virginia
Paris
Perth
Philadelphia
Riyadh*
Rome
San Francisco
São Paulo
Shanghai
Shanghai FTZ*
Silicon Valley
Singapore
Sydney
Tokyo
Ulaanbaatar*
Warsaw
Washington, D.C.
Zagreb*

*Our associated offices

# www.hoganlovells.com