



# China

## Compliance Risk Profile

Last Updated: 3/2020

### Summary

China is the largest exporter (1<sup>st</sup>) and 2<sup>nd</sup> largest importer in the world.<sup>1</sup> China borders 14 countries by land and 7 by sea. It is strategically located on the South China Sea where an estimated \$3.5-5 trillion (USD) in global trade passes each year.

The World Economic Forum's (WEF) Global Competitiveness Report<sup>2</sup> ranks China at 28<sup>th</sup> out of 140 countries analyzed for overall economic competitiveness. Three of the top five problematic factors for doing business in China were listed as inefficient bureaucracy (2<sup>nd</sup>), policy instability (4<sup>th</sup>), and corruption (5<sup>th</sup>).<sup>2</sup> The American Chamber of Commerce in China noted in their 2019 White Paper that business outlook of American businesses in China went from cautious optimism to cautious pessimism from 2018 to 2019 with more than half its membership experiencing an increase in non-tariff barriers in 2018. Partly due to retaliatory tariffs between the U.S. and China, Chinese growth has slowed in 2018 and 2019. It remains to be seen if China and the U.S. will resolve all the current trade disputes. Even with the slower growth, China will account for more than ¼ of global GDP growth in 2019.<sup>1</sup>

From a compliance risk perspective, in the last decade, China has made some improvements in the areas of anti-money laundering, trade facilitation, taxation reform, anti-bribery, rule of law, and government effectiveness. However, corruption, IP piracy and unfair competition remain significant risk areas and due to the trade war and additional recent US sanctions against entities in China, trade area risk has risen. Multi-national companies operating in China should have strong local internal anti-corruption, anti-fraud, and trade & logistics controls in-place as well as periodic monitoring and independent auditing to ensure compliance with Customs, trade regulation, export controls, corporate governance, and anti-corruption laws.

### General Country Information

China has a total population of 1.39 billion<sup>1</sup> with a demographic composition of 91.6% Han Chinese, 1.27% Zhuang, 0.79% Hui, 0.78% Manchu, 0.76% Uygur and 4.8% Other<sup>1</sup>. Most of the population lives in the eastern provinces and along the coast. China has 65 cities with more than 1,000,000 inhabitants with Shanghai (22.3MM), Beijing (11.7MM), Guangzhou (11.1MM), and Tianjin (11.1MM) being the largest. The official language is standard Chinese (Mandarin) and Cantonese (spoken in Hong Kong), however there are an estimated 297 living languages used in the country.<sup>1</sup> There are an estimated 10 million English speakers in China, the majority of which live in the cities. China has a GDP of approx. \$13,047 Billion USD (\$9,368 USD per capita)<sup>1</sup>, and it is the world's second largest state in terms of land area, encompassing about 9.6 million sq. km of land.<sup>1</sup>

### Governance and Regulatory

#### Legislation

Corporate governance for limited liability and joint stock companies in China is primarily governed by the Company Law of the PRC<sup>3</sup> (“Company Law”) and judicial rulings of that law by the PRC Supreme Court<sup>3</sup>.

Effective from January 1, 2020, the PRC Foreign Investment Law<sup>3</sup> will provide regulatory requirements for foreign investors. Foreign investors will also be subject to the implementation regulations and judicial interpretations<sup>3</sup> of the Foreign Investment Law. In principle, foreign investors are not permitted to invest in any of the industries that are specified in *the Negative List of Foreign Investment Admission*, which was promulgated by the ministerial agencies under the State Council and that went into implementation on 30 July 2019. This list may be updated where necessary in the future.

Foreign investors are also required to follow applicable regulatory requirements under the PRC Corporate Law or the Partnership Law depending on which legal form/structure they choose.

Public companies must also comply with the Securities Law of the PRC.<sup>3</sup> The China Securities Regulatory Commission<sup>3</sup> and other stock and trading venues provide corporate governance procedures such as the Code of Corporate Governance for Listed Companies<sup>3</sup> (the Code) and the Guidelines for the Articles of Association of Listed Companies<sup>3</sup> (the Guidelines), etc.

## **Environment**

The 2020 World Bank's **Ease of Doing Business**<sup>2</sup> Report (EDB Report) ranks China overall 31 out of 190 countries analyzed for regulations that are conducive in fostering business activities and those that constrain it.

The World Bank's 2018 Worldwide Governance Indicator (WGI)<sup>4</sup> for **Regulatory Quality** (RQ), with -2.5 being weak and +2.5 being strong governance performance, gave China a score of -0.14 which resulted in a ranking of 109 out of 209 countries analyzed. This represented a slight improvement from the 2009 score of -0.22 and a ranking of 114 out of 210 countries that were analyzed. The RQ indicator “*Reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development*”<sup>4</sup>.

The 2018 WGI **Rule of Law** (RL) indicator gave China a score of -0.20 which resulted in a ranking of 109 out of 209 countries analyzed. This represented an improvement from the 2009 score of -0.41 and a ranking of 122 out of 212 countries. The RL indicator “*Reflects perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence*”<sup>4</sup>.

The 2018 WGI **Government Effectiveness** (GE) indicator gave China a score of 0.48 which resulted in a ranking of 64 (out of 209 countries analyzed). This represented a significant improvement in performance from the 2009 score of -0.09 and ranking of 89 out of 210 countries. The GE indicator “*Reflects perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies*”<sup>4</sup>.

## **Enforcement**

In August 2019, the CSRC gave a rectification order and fines to Kangmei Pharmaceutical Co., Ltd for financial reporting fraud involving 88.6 billion yuan (\$12.6 Bn USD) of overstatements between 2016 and 2018 and for violating the information disclosure law. The CSRC penalized 22 employees of Kangmei with fines (totaling 5.95 million RMB) and banned them from entering the securities markets permanently or for a period of time.<sup>3</sup>

In calendar year 2019, the SAMR imposed restrictive conditions in five foreign investors' M&A cases due to concerns regarding concentration of undertakings from an anti-trust perspective.

GCSG's Compliance Risk Index (CRI) analyzed eight independent factors to score the **governance and regulatory area compliance risk**<sup>5</sup> level for China as **Moderate**.

## **Bribery and Corruption**

### **Legislation**

The major legislation regulating corruption within China is found within the Criminal Code and the Anti-Unfair Competition Law (AUCL).<sup>6</sup> The prohibition on bribery for public officials is found within the Criminal Code and the prohibition against corruption in the private sector is found within both the Criminal Code and the AUCL. Potential penalties are laid out in the Criminal Code and apply to both individuals (giver and receiver) and companies or other legal entities. For individuals' potential penalties include up to life imprisonment and fines. For company's the potential penalties include criminal fines and up to life imprisonment for persons directly in charge or responsible for the offense. The AUCL allows for administrative fines up to 200,000 RMB and confiscation of any illegal gains. The prosecution and police have the authority to investigate bribery and corruption.

In addition, there are certain ministry-level or local regulations or decrees that address specific bribery or corruption issues.

The Supreme People's Court and the Supreme People's Procuratorate have also respectively issued a few judicial notices that elaborate on bribery and corruption issues at a more detailed level.

## **Environment**

Transparency International's 2018 Corruption Perceptions Index<sup>8</sup>, with zero being the most corrupt and 100 being the least corrupt, gave China a score of 39 which resulted in a ranking of 87 out of 180 countries surveyed. Trace International's 2018 Bribery Risk Matrix<sup>8</sup>, with 100 being the most corrupt and zero being the least corrupt, gave China a score of 59 which resulted in a ranking of 134 out of 200 countries surveyed.

The 2018 WGI Control of Corruption indicator<sup>4</sup>, with -2.5 being weak and +2.5 being strong governance performance, gave China a score of -0.27 which resulted in a ranking of 114 out of 209 countries. While not a good score, there was moderate improvement from 2009 to 2018 (2009 score of -0.51 and a ranking of 133 out of 210 countries). The WGI Control of Corruption indicator "*Reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests*"<sup>4</sup>.

Corruption in China often involves state-owned enterprises although it is not uncommon to find corruption in foreign-invested enterprises. The 2016 WEF Enabling Trade Report<sup>10</sup> (WEF Trade Report) listed corruption at the border as the 6<sup>th</sup> most problematic factor for importing into China.

## **Enforcement**

Over the years there have been some high-profile bribery cases in China. In 2019 the US Securities and Exchange Commission charged Jerry Li, a Chinese national with bribing officials in China to obtain licenses, Quad/Graphics, Inc. agreed to pay \$10 million (USD) in fines for FCPA violations involving bribery schemes in China and Peru, and Juniper Networks agreed to pay more than \$11.7 million (USD) to resolve FCPA violations in China and Russia.<sup>7</sup> A Chinese banker was sentenced to death in China for embezzlement and taking \$8.6 million (USD) in bribes<sup>7</sup>. Three employees of Lenovo, a major computer manufacturer in China, were involved in prosecution by Chinese authorities for receiving a bribe, two of whom were convicted for imprisonment in early 2019. In August 2019, Wanda Group, a Chinese multinational conglomerate and real estate developer, turned 4 employees into the Chinese police for investigation for soliciting nearly 100 million yuan in bribes from suppliers and employees.

GCSG's Compliance Risk Index (CRI) analyzed four independent factors to score the **bribery and corruption area compliance risk**<sup>5</sup> level for China as **High**.

## **Trade**

### **Legislation**

The China import and export standards are primarily set out in the PRC Foreign Trade Law<sup>9</sup>, the PRC Regulation on the Administration of the Import and Export of Goods<sup>9</sup>, and the PRC Customs Law.<sup>9</sup> Industrial laws and regulations also provide regulatory requirements for imports and exports. China has included in its December 2019 legislative plan what was a new export control law introduced back in 2017.<sup>9</sup> The draft export control law covers, among others re-exports, deemed exports, embargos, blacklists, and enforcement.<sup>9</sup> The General Administration of Customs ("GAC") is responsible for all imports and exports and has authority over all the customs districts and offices in the PRC.<sup>9</sup> The Ministry of Commerce PRC (MOFCOM)<sup>9</sup> is responsible for developing and implementing policies and plan related to foreign trade, economic co-operation and investment. Among others, MOFCOM is responsible for conducting investigations of foreign parties, approving mergers, foreign direct investments, trade remedies, and for licensing-controlled goods for export. China is a member of the WTO (2001).<sup>9</sup>

### **Environment**

**Facilitation.** The WEF Trade Report<sup>10</sup> gave China an overall score of 4.50, with 6.0 being the best and 2.9 being the worst scoring country in the index. This ranks China 61<sup>st</sup> out of 136 countries that were evaluated for trade facilitation performance. The top 3 most problematic factors for importing, noted in the WEF Trade Report, included tariffs and non-tariff barriers, nontransparent, discretionary and changeable interpretations in local enforcement of regulatory requirements, burdensome import procedures, and high cost or delays caused by international transportation. Technical requirements and standards abroad, identifying potential markets and buyers, and burdensome procedures at foreign borders were the top three most problematic factors for exporting from China. The EDB Report<sup>2</sup> ranks China 56 out of 190 countries for "trading across borders" which includes evaluating the time and cost to export and import. By June 2019, the U.S. had announced several rounds of tariffs on imports from China and China had announced several rounds of retaliatory tariffs on imports from the U.S.<sup>1</sup>

Currently China has free trade agreements with the APTA and ASEAN regional groupings as well as 15 separate bilateral agreements. In 2017, China exported \$2.41T and imported \$1.54T.<sup>1</sup> Its top export destinations were USA, Hong Kong,



Japan, Germany and South Korea and its top exports were broadcasting equipment, computers, office machine parts, integrated circuits, and telephones.<sup>1</sup> The top import origins of China are South Korea, Japan, USA, and Germany and its top imports were integrated circuits and crude petroleum.<sup>1</sup> China has 33 large and 50 small maritime ports.<sup>11</sup>

**Compliance.** While the United States and European Union have sanctions in place against individual persons and organizations throughout the world, neither has comprehensive country-level economic sanctions programs in place against China.<sup>12</sup> The European Union does maintain an arms embargo against China and during the 2017 – 2019 period the United States steadily added additional sanctions against entities in China.<sup>12</sup> A U.S. GAO report<sup>13</sup> indicated China (and Hong Kong) to be a country to watch as a transshipment hub<sup>14</sup> with a potential for higher risk of illicit transshipment. Of the 13 noted transshipment hubs, China had the highest number of parties on the US State and Commerce Department's Watch lists.<sup>13</sup> China is a party to the NPT, Biological Weapons Convention (BWC) and Chemical Weapons Convention (CWC) and is a member of the multi-lateral export control regime Nuclear Suppliers Group (NSG). China is not a party to the multi-lateral export control regimes Wassenaar Arrangement, Australia Group, and Missile Technology Control Regime (MTCR).<sup>15</sup>

### **Enforcement**

In July of 2019, the U.S. was investigating hundreds of millions of dollars in financial transactions involving three Chinese banks. The investigations were begun due to indications the banks were used to generate US dollar transactions that supported the North Korean nuclear weapons program.<sup>12</sup>

In late 2018, the Chinese police cracked a network of export companies that were used to defraud export tax rebates amounting to approx. 1 billion yuan. 22 individuals were arrested for faking transactions, falsely reporting an increased export price and falsely issuing VAT Fapiaos totaling 14 billion yuan.<sup>12</sup>

GCSG's Compliance Risk Index (CRI) analyzed five independent factors to score the **trade compliance area risk**<sup>5</sup> level for China as **High**.

## **Financial**

### **Legislation**

The main legislation governing money laundering in China includes the Criminal Code and a 2006 Anti-Money Laundering Law.<sup>16</sup> In addition, the People's Bank of China (PBOC), China Banking and Insurance Regulatory Commission (CBIRC), and the China Securities Regulatory Commission (CSRC) jointly issued the "Measures for Administration of Anti-Money Laundering and Counter Terrorist Financing in Internet Financial Institutions" on October 10, 2018.<sup>16</sup> The CBIRC issued the "Measures on Administration of Anti-Money Laundering and Counter Terrorist Financing of Banking Financial Institutions" on October 26, 2018.<sup>16</sup> Predicate crimes for money laundering in China's Criminal Code include illegal narcotics, gangs, terrorism, smuggling, corruption, disruption of financial regulatory orders, and financial fraud.<sup>16</sup>

China imposes monitoring on cross-border movement of foreign exchange and conditionally permits or restricts the conversion of currency following the requirements of the PRC Foreign Exchange Regulation that was promulgated by the State Council and effective from 5 August 2008.

China is a member of the Financial Action Task Force (FATF), the Asia / Pacific Group on Money Laundering (APG), and the Eurasian Group (EAG).<sup>17</sup>

### **Environment**

**Access to Finance.** The WEF Trade Report<sup>10</sup> gave China a score of 4.3 (1-7 best) and a ranking of 45 out of 136 economies for access to finance.

**Financial Secrecy and Money-Laundering.** The latest Financial Secrecy Index (FSI)<sup>18</sup> gave China an overall score of 372.58, with 1,590 being the most secret and 16 being the least secret country in the index. This FSI score indicates a moderate concern for financial secrecy. The 2019 International Narcotics Control Strategy Report<sup>19</sup> (NCSR) lists China as a country of concern for money laundering activities. The NCSR report on China said: "Chinese authorities identify illegal fundraising; cross-border telecommunications fraud; weapons of mass destruction; proliferation finance, and other illicit finance activity linked to North Korea; and corruption in the banking, securities, and transportation sectors as ongoing money laundering challenges."<sup>19</sup>

### **Enforcement**

Enforcement is inconsistent but the PBOC has intensified its anti-money laundering enforcement since 2017. The FATF 2019 report on China says, "China is committed to pursuing and confiscating criminal proceeds through both criminal and administrative proceedings, but it should review the functioning and operational independence of its financial intelligence unit

and improve the use of financial intelligence to drive money-laundering investigations.”<sup>19</sup> In June 2019, a third-party payment platform was caught by the Chinese police for money laundering for illegal gambling websites. 95 core members of the third-party payment platform were arrested for laundering 2.8 billion RMB in illegal funds in one year.<sup>19</sup> Also, several top banks and security companies were punished in 2019 by the PBOC due to violations of the Anti-Money Laundering Law.

GCSG's Compliance Risk Index (CRI) analyzed two independent factors to score the **financial area compliance risk**<sup>5</sup> level for China as **High**.

## Data Privacy and Security

### Legislation

The main legislation governing data privacy and security in China includes the Criminal Code, General Provisions of the Civil Law of PRC<sup>20</sup>, PRC Network Security Law<sup>21</sup>, Computer Information System Security & Protection Regulation<sup>22</sup>, and the Personal Information Security Specification<sup>22</sup>. Furthermore, the National Information Security Standardization Technical Committee promulgated and published the state standard “Information Security Technology- Personal Information Security Specifications” (GB/T 35273-2017)<sup>23</sup> as a model procedure for governmental bodies, businesses, and other organizations to follow in terms of protecting data privacy and security<sup>23</sup>. The data privacy and security issue are also addressed in a few special laws that relate to various fields. Examples of such special laws are the Employment Law, the Employment Contract Law, the State Security Law, the Standardization Law, and the Commercial Encryption Administration Regulation as well.

Another couple of draft statutes (including the Personal Information Protection Act<sup>21</sup> (PIPA) – still in draft) are expected to be implemented in the near future with regard to data privacy and security. These draft statutes also include the Data Security Law<sup>21</sup> and its detailed implementation regulation, as well as the Trial Provisions on Protection of Personal Financial Information (Data)<sup>22</sup>. Among them, especially the draft PIPA sets out the scope of personal information and fundamental principles regarding how to solicit and use personal information properly. The personal information is defined to include but not be limited to name, personal ID number, personal biological information, residential address, and contact number, all of which can be recorded electronically or in other manners and according to which a natural person can be vigorously or roughly identified. The personal information is prohibited from being solicited unless permitted by laws or statutes or expressly consented by a personal information owner. In the event where soliciting personal information is permissible, the solicitation must strictly suit a prescribed purpose while any deviations from that purpose must be permissible under laws or statutes or expressly consented by the personal information owner. The personal information must be confidentially used without being accidentally lost or destroyed or illegally solicited, disposed or utilized. Last but not least, it is required that a personal information user must maintain a clear track record of soliciting and using the personal information so as to keep them traceable, updateable and rectifiable.

### Environment

According to SophosLabs' cyberspace security report 2013<sup>24</sup>, China is ranked second from the bottom in terms of cyber security. In view of the threat exposure rate (“TER”), China is at a rate of 21.26%. TER is an indicator referring to the frequency of malware attacks in the last three months. Among all the countries globally, Norway has the lowest TER at 1.81%. In contrast, the US is ranked sixth with a TER rate of 3.82%. Ranked in order of least safe, the five countries that are the least safe in terms of cyber security are Indonesia, China, Thailand, Philippines, and Malaysia.<sup>24</sup>

The 2018 Global Cybersecurity Index (GCI)<sup>24</sup> gave China a score of 0.828 which resulted in a ranking of 27 out of 175 countries. The GCI is a composite index that combines 25 indicators to compare the level of cybersecurity commitment of countries.

The National Internet Emergency Centre (“CNCERT”) carries out routine monitoring of cyber space in view of malware, vulnerabilities & security flaws, mobile web, website & cloud platform security, industrial system security, and internet financing security as well. As per relevant statistics in 2019 and as compared to that in 2018, the cyber security & data privacy incidents in China were increased in relation to zero-day attacks, reported network vulnerabilities, software tampering, backdoor implantation, and counterfeit websites. Therefore, the public and companies operating in China are exposed to a significant risk in terms of cyber security & data privacy.

### Enforcement

The enforcement activities in relation to data privacy and cyber security are carried out mainly by the State Cyberspace Administration, the Ministry of Public Security, the Ministry of Industry and Information Security, and other agencies such as PBOC. In 2019 the authorities intensified their respective enforcement actions in relation to cyber security, cyberspace compliance, and data privacy. For example, the Ministry of Public Security launched a campaign nationwide in 2019 against violations in data privacy and cyber security. As a result, a total of 7647 cases regarding violation of data privacy was detected and 2868 persons nationwide were arrested being suspected of illegally soliciting or abusing personal data.

Most of the PBOC's concern with data privacy was centered on the finance industry. In 2019, PBOC punished nine top Chinese banks as they illegally solicited and abused personal data. Due to the same reason, local affiliates nationwide of PBOC also punished some asset management and security companies.

GCSG's Compliance Risk Index (CRI) does not score **the data privacy and cyber security area compliance risk<sup>5</sup>** level.

## Country Risk Rating

GCSG's Compliance Risk Index (CRI) analyzed 19 independent factors to score the **overall compliance risk<sup>5</sup>** for China at **7.55** (1-10 Highest). This score assigns an overall **High** compliance risk level for multi-national businesses operating within and/or conducting cross-border trade with entities operating within China.

**Note:** GCSG's third-party risk ranking tool (which assesses risk at the entity level), and due diligence reports also incorporate GCSG's country Compliance Risk Index (CRI) scoring and can be used to further drill down on potential risks posed by your supply channel and sales channel third parties. Click [here](#) to learn more.

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