The Era of Compliance in China

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Corporate Compliance has attracted more attention than ever before in China. Driven by the government, initiated by central enterprises, more and more civilian companies, practitioners, and researchers are actively participating in this emerging area. Although some issues still exist, Chinese companies are embracing an era of compliance.

Origin
The origin of compliance theory in China is from western countries. Since the new millennium, many multinational companies have brought compliance concept, culture and approach to their Chinese subsidiaries when they entered China. Chinese international companies have also adopted the global compliance standard when these companies operate offshore. Meanwhile, in order to match the increasing market demands, Chinese offices of several global law firms started their compliance practices in Beijing, Shanghai and Shenzhen.

The motivation for Chinese companies to adopt corporate compliance generally comes from three aspects:

(1) Administrative incentives and incentives from the Chinese government;
(2) foreign compliance requirements and influence;
(3) self-motivation.

Financial Compliance
The Chinese government started to enforce compliance requests in the financial industry. In 2006, the China Banking Regulatory Commission (CBRC) released the Guidelines for the Compliance Risk Management of Commercial Banks. In 2007, China Insurance Regulatory Commission (CIRC) released the Guidelines for the Compliance Management of Insurance Companies, which was later replaced by the Measures for the Compliance Management of Insurance Companies in 2016. In 2008, the China Securities Regulatory Commission (CSRC) released its Tentative Provisions for the Compliance Management of Securities Companies. In 2017, the CSRC issued the Administrative Regulation for Compliance Management of Securities Companies and Securities Investment Fund Management Companies, to replace its previous rule. The Compliance and Bank’s Internal Compliance Departments released by the Basel Banking Regulatory Commission is the blueprint for these three regulations. The Chinese administrative agencies force commercial banks, insurance companies, securities companies, and fund companies to establish a compliance system according to these rules and guidelines allowing the agencies to issue sanctions for any violation. For example, the Central China Securities

1 The definition of “Central Enterprises” is Chinese state-owned companies funded and supervised by the State-owned Assets Supervision and Administration Commission of the State Council (“SASAC”).

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was forced to correct its wrongdoing because its compliance management and internal control are flawed, especially “1. the company's compliance awareness is weak, the compliance personnel is insufficient; 2. the enforcement of compliance management regulation is ineffective; 3. the company emphasizes business income and ignores risk control; 4. the examination and motivation mechanism is missing.”

Central Enterprises and State-owned Companies Compliance

In November 2018, the Chinese State-owned Assets Supervision and Administration Commission of the State Council ("SASAC") issued the Guidelines for the Compliance Management of Central Enterprises ("for trial implementation"). The following month, the National Development and Reform Commission of China ("NDRC"), SASAC, and other four government sectors jointly released the Guidelines for the Compliance Management of Enterprises' Overseas Operation. Following the release of these two guidelines, almost all local state-owned assets supervision and administration commissions released their similar guidelines for state-owned enterprises under their supervision. These guidelines made compliance mandatory for central enterprises and state-owned enterprises. At the same time, these guidelines contains principles and methodologies to help enterprises establish a proper compliance system.

Notably, these guidelines require state-owned companies to establish a very comprehensive system. The Guidelines for the Compliance Management of Central Enterprises identify at least seven categories of compliance risks, and requires compliance system cover all employees from top to bottom. The operation, supervision, audit, internal control, risk management, production safety, HSE, and all other sectors responsible must collaborate to manage the overall compliance of the whole company.

Administrative Supervision and Administrative Incentives

As discussed in the previous section, the government has been using administrative power to lead compliance activities. The government-issued guidelines and regulations asked for state-owned entities to establish a compliance system, submit the compliance report, assess the compliance result, and be supervised by administrative agencies. The extreme/radical measures carried out by the government have seen impressive success, with most Chinese state-owned enterprises and financial institutions building their own compliance teams to implement compliance systems.

Some administrative agencies, such as CIRC, have adopted a compliance settlement mechanism that allows companies to commit to meeting specific compliance requirements in exchange for a reduction of sanctions. However, only a few administrative agencies have adopted similar approaches to promote compliance activities. Many Chinese administrative agencies have the authority to issue penalties and corrections, such as license suspension, fines, confiscation, etc. Still, most administrative agencies do not consider the existence of an adequate compliance system or specific compliance commitment as a basis to reduce potential penalties. The CIRC has published two model cases during past years, but their content is ambiguous. In the two case reports, charged companies were required to "implement necessary measure to enhance the internal control and submit a written correction report to CIRC after the correction." However, the CIRC has not disclosed the standard of the enhanced internal control system or the content of written correction reports yet.

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3 The guideline actually list eight categories: (1) Market transaction; (2) Safety and environment protection; (3) Product quality; (4) Labor and employment; (5) Finance and tax; (6) Intellectual property; (7) Business Partner; (8) Other important areas.
Moreover, monitoring, continuous improvement, periodic testing, and review are vital factors to evaluate a compliance system. These factors are missing in these two model cases. The market is still waiting for a more precise guideline on administrative settlement mechanisms.

Concerning administrative supervision, the Chinese government is still exploring the use of administrative power to create compliance incentives. Nowadays, compared with the "pushing power" arising from the administrative rules and guidelines, the "pushing power" arising from the administrative incentive is still under development in China.

Standardization
In 2017, the Standardization Administration of China released the national standard, the Guidelines on Compliance Management System (GB/T 35770-2017), which came into effect as of July 1, 2018. This standard is a translation of ISO 19600: 2014, collects the internationally recognized practices in compliance management and provides Chinese companies a systematic guide to strengthen compliance management, improve compliance skills and build an effective compliance system. This effort distinguishes itself from other regulatory or administrative requests driven by the government.\(^5\)

Another source for the standardization of compliance efforts is the Integrity Compliance Guidelines from the World Bank Group, which also collects standards, principles commonly recognized worldwide, especially for company governance and anti-fraud and corruption areas. Although the Guidelines are designed for the World Bank sanction system as a condition to end debarment, it is also a valuable tool for Chinese companies to establish a compliance system to bridge the gap from the international standard.

The introduction of the international practice and standardization help many Chinese companies to learn the principles of compliance and establish a modern compliance system quickly. However, compliance standardization has its side effects. To meet compliance requirements in the short term, the compliance team may ignore the risk assessment stage and adopt standardization documents directly. "One fits all" compliance plans are easy found among Chinese companies. Many companies treat compliance management as a slogan for modern management, as they obtain a third-party certificate to show the company is reliable, and then stop maintaining the compliance system with continuous improvement. In such case, compliance system is just an vanity. The reason behind this phenomenon is that the incentive for compliance is inadequate in China. Except for state-owned companies and highly regulated industries, compliance requirements for many civilian companies in China are still social responsibilities and moral obligations. Many Chinese companies, especially domestic companies, have not realized the value of corporate compliance.

New Incentives
To promote compliance activities in China, the Supreme People's Procuratorate of the People's Republic of China ("SPP") has implemented a pilot program for corporate compliance ("Pilot Program"). This Pilot Program creates strong incentives for corporate compliance and will soon reform the legal framework of corporate compliance in China.

In March 2020, the SPP carried out the Enterprise Compliance Reform Pilot Program in six local procurators. In April 2021, the SPP issued the Plan on Carrying out the Pilot Program of Enterprise Compliance Reform to launch the second phase of the Pilot Program. The Pilot Program enables the procuratorate to make decisions of non-prosecution, disapproval of arrest, or lenient sentencing proposals, which will urge

\(^5\) The standard administration is a branch of the government, under the supervision of state administration for market regulation of China. However, the guideline is not mandatory guideline, it does not “make specific requirement for organization compliance management, only offer guideline and suggestive method for establishing a compliance management system.”
suspected companies to make compliance commitments and actively implement effective compliance plans.

On July 3, 2021, SPP published four model cases under the Pilot Program to report the periodical results. In the Four Model cases\(^6\), the local procurators promote corporate compliance through three aspects:

(a) **Non-prosecution**

Article 177 of the Criminal Procedure Law of China permits the prosecutor not to initiate a prosecution where circumstances of a crime are minor, and no criminal punishment is necessary, or the criminal suspect is exempted from criminal punishment per the Criminal Law of China. The local prosecutors decided not to initiate the prosecution in two of the four model cases. The issue with the non-prosecution system is that it only applies to miscellaneous matters. Bribery, money laundering, fraud, and other commercial crimes always involve a high volume of money, and the circumstances of these crimes are not miscellaneous. Therefore, at least under the current criminal law framework, the scope of application of non-prosecution is limited.

(b) **Plea of guilty and punishment leniency**

According to Article 15 of the Criminal Procedure Law of China, a criminal suspect or defendant may be granted leniency per the laws where they voluntarily and truthfully confess to their crime, admit to the charged crime facts, and is willing to accept punishment. Two of the four model cases reflect this rule. The issue for linking corporate compliance and this rule is that corporate compliance has not been introduced as a factor for convincing and sentencing in the statute. Under the Criminal Law of China, the application of punishment leniency and punishment waiver is strictly regulated. Thus, the leeway for punishment leniency to promote corporate compliance is strictly controlled, so it cannot create strong incentives for corporate compliance.

(c) **Procuratorial proposal**

A procuratorial proposal is a new tool for procurators in China. Prosecutorial proposals include the following types: (a) procuratorial proposals for retrial; (b) procuratorial proposals for correction of illegality; (c) procuratorial proposals for public interest litigation; (d) procuratorial proposals for social governance: and (e) other procuratorial proposals.\(^7\) Procurators make the proposals of corporate compliance to suspected entities in all of the four model cases. In the case of **Zhangjiagang L Company**, after the procurator made the non-prosecution decision, the procurator then referred it to administrative agencies through procuratorial proposals for administrative fines. In **Shanghai A company, B company, and Guan**, the procurator found the charged company failed to implement a corporate compliance system when it revisited the company after the trial. Then, the procurator issued a procuratorial proposal to the company to force it to adopt an effective compliance system.

Under the current situation, the corporate compliance activities led by the SPP have two other issues: (a) the branch of procurature is separate from administrative branch of the

\(^6\) The four cases are *environmental pollution by Zhangjiagang City L Company, ZHANG et al., People v. Shanghai A Company, B Company and Guan, a case of falsely issuing special value-added tax invoices, People v. Wang, Lin, and Liu, a case of bribery*, available at https://www.spp.gov.cn/spp/xwfbh/wsfbh/202106/t20210603_520232.shtml, last visit at 08.05.2021.

\(^7\) *Provisions on the Procuratorial Proposal Work of People’s Procuratorates* https://www.spp.gov.cn/spp/zdgz/201902/t20190226_409297.shtml, last visit at 08.05.2021.
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government, and its primary duty is public prosecution; (b) the deferred prosecution system
does not exist in the current legal framework. Unlike the Department of Law in the United
States, the Chinese branch of procuration is separate from the administrative branch of the
government. The SPP reports to the National People’s Congress directly, and its primary
duty is public prosecution. Whether the procurators will be motivated to pursue corporate
compliance in the long term under the current government structure should be examined
by time. For the second issue, some scholars suggest the SPP can use the bail period to take
the place of DPA during the experimental period. According to the Criminal Procedure
Law of China, the bail period shall be on longer than twelve months. People have already
recognized that the twelve months period is insufficient for procurator and suspected
companies to reach its goals in many complicated cases.

In sum, the Pilot Program is an experiment made by the procurators to explore the
incentives for corporate compliance, and relevant issues are likely to be resolved through
new legislation as the Pilot Program moves forward.

Corporate Compliance Monitorship

Corporate compliance monitorship does not exist in the administrative settlement
procedure, but exists in the Pilot Program. The monitorship project needs tremendous time,
professionals, and investment. Monitorship is a key for an effective corporate compliance
system and a heavy burden for administrative agencies and procurators. Based on the
experience of the First-Round Pilot Program, the SPP, Ministry of Justice of China,
Ministry of Finance of China, All-China Federation of Industry and Commerce, and other
six organizations issued the Guiding Opinions on Establishing the Compliance third-Party
Supervision and Evaluation Mechanism for Enterprises Involved in Cases (for Trial
Implementation). The third-party supervision and inspection management committee has
the authority to appoint third-party supervision and evaluation organization (“Third-
party”). When the procurator has a corporate crime case meeting the standard of the Pilot
Program, the Third-party will evaluate the issue and investigate, evaluate, supervise, and
inspect the compliance commitments made by the charged companies. The Third-party
report will be an essential reference for procurators to handle cases. The Third-party
consists of lawyers, auditors, accountants, federations of industry and commerce,
associations of enterprises. Lawyers are the most active parties in this practice area. Several
local bar associations have established their internal rules of qualified Third-party election.

The monitorship program is considered as the core of the Pilot Program, but the program
is still at a its early stage. Many problems with monitorship are still waiting to be resolved.
For example, the government has not published a guideline on evaluating whether a
corporate compliance system is effective. The administrative agencies, procurators, and
third-party are still exploring their best practice.

Overseas Compliance

As Chinese companies start to invest, operate, and go public in the foreign market, they
must obey relevant foreign laws and regulations and establish a compliance system
accordingly. In areas like anti-money laundry, foreign bribery, intellectual property, export
control, merger and acquisition, and data privacy protection, such compliance requirements
have become stricter than ever. FCPA, UK Anti-bribery Act, GDPR, and other long-arm
laws force the Chinese companies with international business to establish a compliance
system to control the non-compliance risk. Export and import compliance are essential to
corporate governance in many Chinese companies. Today, Chinese companies will not be
surprised to receive an end-user certificate from a US customer.

Besides foreign countries, international organizations, such as the World Bank Group, also
push Chinese companies to adopt a compliance system. The World Bank Group has
sanctioned many Chinese companies because of false statements in the bidding process,
corruption, conspiracy. Sanctioned companies may commit to establishing an effective
compliance system in order to be released conditionally from the ineligible list. In past few years, some Chinese companies established or polished their compliance systems through such process.

**Self-motivation**

Since China's economic reform and opening in 1978, the corporate governance culture has evolved to a modern model. “Continuous development,” “social responsibility,” and “overall risk control” are widely accepted among Chinese companies now. In Analects, Confucius said, “Riches and honors are what all men desire. But if they cannot be attained in accordance with the way, they should not be kept.” Linking ethics and social responsibilities to compliance meets the Chinese traditional business philosophy and can be easily understood by many Chinese companies. A culture of compliance is welcome by most Chinese companies.

Chinese companies have recognized the value of compliance in doing business. The purpose of compliance is not to abandon the business interests or take social responsibilities unconditionally. The purpose is to gain trust in the market, improve corporate governance, control administrative and criminal punishment risk, and pursue continuous development.

**The Future**

As mentioned above, corporate compliance has become an unstoppable wave over Chinese companies. Within two years, almost all the state-owned companies in China have established a compliance system. Administrative settlement and Criminal NPA and DPA are also on their way to be implemented broadly. Chinese companies are looking forward to more social, administrative, and criminal incentives to implement an effective compliance program.

The legal job market has started to adapt to these changes. Corporate compliance is no longer just an international practice, and law firms start to shift their focus on domestic corporate compliance. The compliance officer has also become a new occupation in the legal market.

Civilian companies contribute around 50% tax, 60% GDP, 70% technical innovation, and 90% commercial entities to Chinese society. Civilian companies’ corporate compliance is essential to the continuous and stable development of China.

Exploration of mechanisms to encourage civilian companies to create a compliance culture and adopt an effective compliance system will be a primary task for China. Predictably, more civilian companies will join the trend of corporate compliance.

As discussed, although there is still a long way to go, the Era of Compliance has arrived.

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8 For example, see the case of Hunan Construction Engineering Group Corporation, which was released from the list of ineligible entities and individuals at 2017. The sanction notice is available at https://www.worldbank.org/content/dam/documents/sanctions/office-of-suspension-and-debarment/2018/nov-1/Notice-of-Uncontested-Sanctions-Proceedings-Case-268.pdf.

9 At March 2021, the Ministry of Human Resources and Social Security of China listed compliance officer a new job category.
Nanshan Group was established in July 1992, a company controlled by the Nanshan Villagers’ Committee. The predecessor of the Nanshan Group was Qiansong Village Glass Fiber Factory a village-owned enterprise in Dongjiang Town, Longkou City, which was established in 1979. Nanshan Group focuses on the business of aluminum, textile and apparel in both of domestic and overseas markets. For the year ended 2020 December 31, the group has approximately 400,000 employees and an income of RMB 48.9 billion, respectively.