

## COMPLIANCE MANAGEMENT AND COMPLIANCE TRAINING IN CHINA

Tiezheng Li

### AUTHOR

*Tiezheng Li is research director at the China Center on Corporate Legal Affairs Management, a leading think tank dedicated to the Chinese in-house counsel community. He gives lectures, organizes training programs and provide consulting services to large Chinese domestic companies on compliance management.*

### ABSTRACT

*This essay provides an overview of the compliance management and compliance training in China. It explains the factors behind a growing awareness of compliance management among Chinese domestic non-financial companies. It also discusses some typical culture challenges discovered during the compliance trainings for Chinese companies and their newly established compliance function.*

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## TABLE OF CONTENTS

I.	THE CHANGING LANDSCAPE OF COMPLIANCE MANAGEMENT IN CHINA	71
	A. The old landscape	71
	B. The growing awareness of compliance	72
	1. Anti-corruption campaign	72
	2. Growing legislative and enforcement effort	72
	3. International expansion	73
	4. Government advocacy	73
II.	COMPLIANCE TRAINING IN CHINA: A GROWING INDUSTRY	74
	A. Compliance training in China	74
	B. Culture clashes in understanding compliance	74
	1. Legal culture difference	74
III.	POLITICAL CULTURE DIFFERENCE	75

## I. THE CHANGING LANDSCAPE OF COMPLIANCE MANAGEMENT IN CHINA

### A. The old landscape

“Compliance” used to be a term that was mainly familiarized by managers and employees of foreign multinationals in China. People commonly understand the word “compliance” in the context of FCPA, which is the abbreviation of “Foreign Corrupt Practices Act” and the abbreviation itself has successfully entered the Chinese language.

FCPA compliance is the number one task for the compliance function of most foreign multinationals in China. The number of Chinese compliance professionals hired by foreign multinationals and the legal spending in compliance related investigations (both external and internal) have multiplied against the backdrop of heavy enforcement of US authorities since around 2008. According to the “Foreign Corrupt Practices Act Clearinghouse”<sup>1</sup>, China is the location with the highest number of US FCPA enforcement actions between 2008 and 2017. 46 FCPA cases involves a bribery scheme inside China. In comparison, Gabon, the number two location on the list, has only 17 associated cases.

Aside from foreign multinationals, there is a distinctive Chinese domestic industry that has familiarized the term compliance the financial industry. Banking, insurance and securities are three subsets of Chinese financial industry. Each of the three has its own industry regulator, namely China Banking Regulatory Commission (CBRC), China Insurance Regulatory Commission (CIRC), and China Securities Regulatory Commission (CSRC). All three financial industry regulators have issued their “Guideline for Compliance Risk Management” for their respective sector<sup>2</sup>, which set a mandatory requirement for any financial institutions in these three sectors to establish a compliance management program. The origin of the compliance requirement in the Chinese financial industry could be traced back to China’s accession to the Basel Global banking regulatory committee. In 2005, Basel Committee on Banking Supervision issued a high-level paper on compliance risk and compliance function in banks.<sup>3</sup> Subsequently, CBRC, which is a member of the Basel Committee, adopted the concept and issued its compliance management guideline for Chinese banks. The core concept and wording of this guideline is largely in line with the Basel high level paper.

For most Chinese domestic companies that are not part of the financial industry, until very recently, “Compliance” was not a common word in their vocabulary. Chinese companies generally do not have a culture of compliance. Although Chinese central and local government as well as various ministries and government departments issued thousands of laws, regulations and guidelines, their enforcement are often selective. Chinese officials

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<sup>1</sup> StanfordLawSchool, *Foreign Corrupt Practices Act Clearinghouse- a collaboration with Sullivan & Cromwell LLP* (Aug. 30, 2017), <http://fcpa.stanford.edu>.

<sup>2</sup> China Banking Regulatory Commission, *Guideline for the compliance risk management of commercial banks* (Mar 1, 2005).

<sup>3</sup> Basel Committee on Banking Supervision, *Compliance and the compliance function in banks* (2005).

have large discretion in the law enforcement and their power are merely challenged by the judiciary. Violation of laws and regulations may not meet consequences as long as the business owner obtains good relationship with government officials. As a result, courting the government officials and cultivating a good relationship is more effective than the often too costly compliance management effort.

## B. The growing awareness of compliance

There is however a sense of changing attitude towards compliance in the last few years. Chinese business leaders and government officials spoke out in many occasions on the importance of compliance. This growing awareness could be tied to a joint force of the change of political environment, intensified regulatory action, growing international expansion of Chinese companies, and strong advocacy from Chinese government.

### 1. Anti-corruption campaign

A far reaching anti-corruption campaign began in China following Chinese president Xi Jinping coming to power in late 2012. Over hundreds of high ranking government officials, including national political leaders, high-ranking military officers and senior executives of State Owned Enterprises (SOEs), have since been removed and charged with alleged corruption. A much larger number of government officials with less higher rank were disciplined and indicted. The campaign has affected across the country leaving no industry or government branch intact.

The anti-corruption campaign has fundamentally changed the political environment in China. There is a general sense of insecurity among Chinese business leaders, as their powerful patrons may suddenly fall from grace. Business owners and senior executives of both state-owned and private companies started to question their long-cultivated relationship with government officials, which may now turn into a liability that will implicate them to corruption charges. It is now easier to convince the business leader to adopt a compliance program that could help to reduce their risk exposure to law enforcement action.

### 2. Growing legislative and enforcement effort

Growing legislative effort and enforcement actions in combating corporate wrongdoings is also an important factor. Chinese Anti-Monopoly Law was in effect in August 2008 and has been rigorously enforced after 2010s. One landmark case in 2013 involves two luxury liquor producers Maotai and Wuliangye for forming vertical monopoly agreement with their sales representatives. NDRC, China's top Anti-Monopoly Law enforcement agency, fined two liquor producers for 450 million RMB (roughly 65 million USD), which was 1% of their total annual revenue. Such hefty fine was unheard of in China before. The hefty fine plus the prominence of the two brand-names, helped the case to reach national-wide media attention.

Other notable legislative development includes the revised Consumer Protection Law in 2014, the revised Work Safety Law in 2014, the new Environment Protection Law in 2015. All the revisions and the newly drafted legislation aimed to increase the consequences for Chinese corporation that does not comply with the regulations. In early 2015, the judicial

interpretation of the Supreme People's Court on the application of the China Civil Procedure Law was also an important milestone, as it has lowered the procedural requirement for Non-government organizations (NGOs) to bring a civil lawsuit against a corporation on behalf of a collective group. Most of such type of lawsuits are related to environmental and consumer protection. Although the Chinese procedure is very different to US class action litigation and no punitive damages will be rewarded, it is still an advancement of the interest of ordinary citizens against corporate wrongdoings.

### 3. International expansion

The recent period also witnessed Chinese companies' global expansion and new compliance challenges aroused from its global operation. Chinese home-grown multinationals were under intense scrutiny by the US regulators in the area of sanctions and export control as well as anti-money laundry. The ZTE case was widely cited as a wake-up call for Chinese multinationals to improve their global compliance management. ZTE was fined for over 800 million USD for violation of US export control regime in re-selling imported US equipment to Iran and North Korea. As part of the settlement agreement with DOC, ZTE agreed to establish a compliance program under the supervision of a court appointed monitor, who will report to the court on the progress made by ZTE for the next 3 years. Failure to build an effective compliance program in accordance of US requirements will result in an additional fine of 300 million USD.<sup>4</sup>

Another notable case is the 200 million USD fine to the New York brunch of China Agriculture Bank for inadequate effort in managing anti-money laundry compliance. The installment of a monitor and the requirement to improve its compliance program were also part of the settlement. In both ZTE and China Agriculture Bank cases, the attempt to cover up and non-cooperation with government authorities in their investigation has costed the companies extra hefty fines. Chinese companies are learning in a hard way the culture differences in dealing with US agencies and the US judiciary system and complying with legal requirements.

### 4. Government advocacy

Finally, Chinese government played a significant role in encouraging SOEs to build up a compliance management system similar to their western peers. China State Asset Administration and Supervision Commission (SAASC), the supervision agency of SOEs under the management of central government, advocated the idea of compliance management among central SOEs. Five large SOEs including Sinopec, China Mobile, were selected by

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<sup>4</sup> Office of Public Affairs, *Secretary of Commerce Wilbur L. Ross, Jr. Announces \$1.19 Billion Penalty for Chinese Company's Export Violations to Iran and North Korea*, DEPARTMENT OF COMMERCE – UNITED STATES OF AMERICA (Mar 7, 2017), <https://www.commerce.gov/news/press-releases/2017/03/secretary-commerce-wilbur-l-ross-jr-announces-119-billion-penalty>.

SAASC to start a pilot program to study and experiment building up compliance program in Chinese SOEs<sup>5</sup>. SAASC plans to issue a compliance management guideline for all central SOEs based on the experiences of these five companies.

The advocacy from SAASC is a response to the above listed recent developments. SOEs were in the epic center of the anti-corruption campaign. NDRC, a powerful regulator, did open anti-trust investigation against large SOE Telecom operators. The over 100 central SOEs have in total more than 8500 overseas branches in 150 countries. Their total overseas asset has exceeded 5000 billion RMB<sup>6</sup>. Compliance management seems to be a solution to reduce the risk of hefty fine or allegation of corporate wrongdoings.

## II. COMPLIANCE TRAINING IN CHINA: A GROWING INDUSTRY

### A. Compliance training in China

Compliance training is an important element of an effective compliance management system. It helps company employees to familiarize with policies and procedures, convey tones from the top, and foster a culture of integrity. The growing awareness of Chinese local companies has created new demand for training programs.

### B. Culture clashes in understanding compliance

Compliance and compliance training is quite a new thing for many Chinese domestic companies. Current compliance training programs are an excellent place to make observations on the clash of culture between foreign multinationals and Chinese domestic companies.

#### 1. Legal culture difference

In the program, speakers from foreign multinationals often talk about a good culture of compliance that should encourage employee “adherence to the spirit and letter of the formal rules”<sup>7</sup>. But Chinese compliance officers participated in the program, who normally have a background in Chinese law, would often dispute the concept. They would rather like to understand the law as it is written in black letter.

It is easier to convince the company and its employee to comply, when a specific provision of the law forbids a very precise type of action. For instance, the Chinese Anti-Unfair Competition Law contains a requirement for the merchant that the maximum payment

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<sup>5</sup> State-owned Assets Supervision and Administration of the State Council, *2016 Report on the progress of rule of law in central SOEs*, (Mar 31, 2017) <http://www.sasac.gov.cn/n103/n2190709/n2281959/n2281991/c2568112/content.html>.

<sup>6</sup> Data from SAASC.

<sup>7</sup> BEN W. HEINEMAN, JR., *HIGH PERFORMANCE WITH HIGH INTEGRITY* (2008).

in a raffle promotion should not exceed 5000 Yuan. 5000 Yuan is a very precise requirement, which makes employee easy to understand the standard of compliance.

Many government regulations, especially policies and guidelines from the industrial regulator, are writing in such a precise way. Oftentimes, it is designed to address a specific situation in a particular context. Chinese business people pay high attention to this type of micro-management of the government, which could be traced back to China's history of planned economy.

On the contrary, Chinese business people often ignore the "modern" statute like China anti-trust law (China Anti-Monopoly Law) and consumer protection law, as they are principle based and do not provide very precise guideline to their business activities. This may expose the company to greater risk.

The different understanding of the meaning of law highlights the importance of compliance training to an effective compliance program. In fact, the purpose of compliance training inside the company is for compliance function to have conversation with the business people on the practical application of the legal principles.

### III. POLITICAL CULTURE DIFFERENCE

The lack of trust is also reflected in the discussion of whistle-blower program. Foreign multinationals see whistle-blowing as a channel for employees to raise their concerns. It is a duty for people with integrity to report any wrongdoings.

Many Chinese compliance officers believe most whistle blower, who turn in their colleagues, has very negative characters. They believe that once in place, the program would certainly be misused for office politics.

The different attitudes towards whistle blower seems to reveal a deep political culture difference. During the Chinese Culture Revolution, people were encouraged to spy on each other and turn in the friends and family members to the authority for alleged anti-revolutionary behavior. In many cases, it was a political witch hunt that created mistrust in the society.

It is still early to predict how the new trend of interest to compliance management may actually prepare Chinese companies to face their global regulatory challenges. Given the deep culture differences, compliance training in China has a very difficult task to change the mindset of many Chinese companies.