

China Briefing

China's new Civil Code, and why you should care

Foreword

Our last update concerned the Two Meetings. This fortnight, we concentrate on China's just-passed Civil Code, which outlines the rules of how the government, business and society are to interact, acting as a sort of encyclopaedia of social life. This was the fifth attempt by the Chinese Communist Party to pass a Civil Code: China's previous leaders all failed in their efforts.

The new Code will take effect on 1 January 2021. It codifies, modifies (in some respects) and replaces the China's current laws of contract, property, guarantee, tort, marriage, succession and adoption, as well as the general principles and rules of civil law. In doing so, it touches on every aspect of civil and societal life. It is the longest Chinese law ever written.

In this Update, we will look at what it means for two major business issues: e-commerce, and land and property rights. For other thoughts, or if you have any specific questions, please get in touch with our China team.

Why the Civil Code?

Communist parties like civil codes. That is because they prefer systems of law where judges are required to look at what has been legislated, rather than on previous cases forming precedents. Having a Civil Code reduces the need for leaders to determine what they want the law to be — as they affect everyone in the nation — and so introducing a Civil Code is often a priority upon coming into power. The Soviet Union for example introduced its Civil Code in 1922.

China's constantly swirling relationships between the market, society, and the ruling government has made all attempts to introduce a Civil Code thus far fail. The first attempt was in the 1950s, specifying how the Communist Party would lead all society and business. The next attempts were after the Mao period when markets were introduced and China began opening up, changing the relationship between economics and the people. With all of these having failed, efforts resumed in late 1998 as part of the preparation for China joining the WTO (and after China changed its constitution from saying that it was a "planned economy" and instead became a "socialist market economy" in 1993). Finally in 2014 as part of China shifting to a focus of being governed by law the legislators were told to prepare a fifth attempt at a Civil Code.

Why did it succeed this time? Because it was made a distinct priority at the top. Despite what one may read in popular media, Xi Jinping particularly likes laws. China has introduced an array of legislation during his administration aimed at codifying powers that were previously only held by the Communist Party. This includes powers over national security and over anti-corruption bodies. The Civil Code is in many ways the crowning moment of Xi's push for legislation and for China to be "ruled according to law".

Why should we care about this?

China's social and economic transition has been extraordinary, seeing it open its economy and society to the world, and remove its direct control over people's lives. China has come a long way from when the Party told you where you would work and how you would live your life. The economic changes have been particularly radical. But the system of rules keeping all of this in place have not always kept up. While

China has developed its own laws — many of which it borrowed ideas from more developed legal systems — there is no overall framework, leaving courts to issue an array of interpretations and policies in order to get around problems of insufficient laws. This has occurred mainly through "guiding" cases, examples issued at the top in order for the lower courts to follow. But a guiding case system is a patch, not an operating system: it is better to outline what it wants everyone to think and have them follow it. The Civil Code wires the house and puts in the plumbing.

What does it mean for investors? It gives foreign businesses a clearer idea of what to expect before putting money in. Having a Civil Code moves decisions from out of the hands of the bureaucrats and top judges to those of the judges responsible for applying the law. More specifically, a Civil Code mediates the differences between state interests and private property and personal rights. It improves the legal protections for Chinese citizens, companies and other organisations. This does not mean that it creates a "rule of law". Rather, it gives a more structured way of understanding where everyone sits vis-à-vis their actions and the law. China is a written culture, and modern China a highly litigious society, albeit still one where many of the frictions of daily life are expected to be solved through informal means. The goal of the Civil Code is to formalise ideas such as concepts of what is fair and reasonable. (Previously principles were required just to be fair. When you're applying a statute imposed from above, fairness is a much easier state to justify. Adding the idea of "reasonableness" makes it much more likely that companies and individuals can seek market rate compensation for when outsiders or the government encroaches on their interests).

Specific areas of interest: online rights

Of particular interest to us, given our investment relationship with Tencent, is how the Civil Code seeks to protect personal information online, and balance that of the requirements of China's booming e-commerce industries. This is an issue of great concern due to many high profile cases where personal information was leaked online.

China's e-commerce sector is far advanced beyond anything that can be seen in the West. Private companies can effectively coordinate big data nationwide, unlike the government, which is unable to unify its

holdings in one place. So there is a constant push and pull between China's tech behemoths and senior bureaucrats, seen in the recent introduction of strict privacy and data encryption laws.

The new Civil Code goes one step further, and devotes one entire chapter of the seven to outlining people's rights to having a name, title, portrait, reputation, and privacy — in essence, protecting personal information. Rather than just having a right to privacy, instead one has a right that their personal information not be used to make money, and allows legal claims to be made against those who do not follow this. It is a significant advance on previous efforts, perhaps the second-strongest regulatory system in the world at present. (The strongest, the EU's GDPR, also regulates how long information can be kept for and the circumstances under which it may be collected). Comparing these reforms to China's social credit system, a common trope in popular media, shows the impact of the Civil Code. The social credit system is a desired goal that local governments are to implement using their own methods, systems and goals. The Civil Code gives unalterable rights to citizens and businesses, and local governments not only must comply but can be taken to court by citizens should they fail to do so.

This reflects a couple of things. Firstly, Chinese citizens' worries about being ripped off in online scams — a constant concern — and also their concern about the future impacts of technologies such as data collection, and biometric surveillance recognition. Secondly, an attempt to balance out traditional civil law having a greater emphasis on property rights protection over personal rights. Thirdly, a desire to keep the government in check: there is a significant grey market in paying for records to be added to, changed or deleted within Chinese bureaucracy. (A number of those who fell in the first wave of anti-corruption were sacked for taking bribes to delete or falsify government records).

What does this do? It will, we believe help in protecting Chinese consumers. It will also entrench the positions of current market leaders Alibaba and Tencent. That is because the user agreements, and preferential status, that both firms have will be concentrated yet further under the Civil Code arrangements. Meeting the Civil Code requirements will be a barrier to entry for new tech players (and entering the tech market is already incredibly onerous: one WeChat message alone has 11 different regulators spread across three different tiers of government). So China's new tech giants are likely to stand on Alibaba and Tencent's shoulders. But these two major companies will also have to do most of the negotiations with China's government and ruling Communist Party as to who has access to their users' data.

Specific areas of interest: land rights

Perhaps the most significant change in the Civil Code involves land. At present, the Chinese state owns all the land, but it grants people the rights to own or use it. The now-defunct Property Law of China outlined the tension in this: you could "possess, utilize, dispose of and obtain profits from (a) real property" but you could "harm neither public interests nor the legitimate rights and interests of others".

Clearly, this remains of concern for many citizens. How can a judge decide how to assess a landlord dealing with a tenant who claims that they are harming their rights? A land user obtains only the land use right, not the land or any resources in or below the land; there are still more complications when one considers that a resident can own an apartment, but not a house, and a construction company can sell that same flat, but not own the land that it has been built on.

Structural issues with land shape much of how China works. For governments, contracts are between the user and the land administration department of the people's government at municipal or county level. These land sales are used to fill shortfalls in revenue. Land also can be used as collateral for local debts. Each government

agency or local government wants a piece of the pie. And for business, land acquisition (and speculation) take up much time. Even in booming Shenzhen, the heart of the technology sector, there were recent reports of firms spending 80% of their time in order to make sure that they have headquarters and places to do work.

The Civil Code outlines ways to transfer land use rights. It also spelt out homeowners' rights, including their entitlement to income generated from their properties (the old Law did not address cash from advertisements for example). The Civil Code also granted a number of rights to renters, making it more difficult for landlords to evict tenants.

The transfer of land rights is the most important function. At the moment, Chinese families can only use the land for 70 years, and the land is owned by the state. The new code affirms that land use rights for residences will be automatically renewed after expiration but left it vague with the homeowners need to pay for renewal or obtain it free. Interpretations noted that this will allow reverse mortgages. It appears that it may also allow a form of freehold to develop in China. The exact details are to be filled out in the coming months.

Why leave this vague? Mainly, because the government wants to make sure that rural land rights are decided by local committees. Much of this was outlined last year in an array of party regulations concerning so called rural revitalization. This plan stated that by 2022 China would have a way to protect and trade rural property rights, that the gap in quality of public services between the rural and urban areas would not worsen, and finally that "economically developed regions, metropolitan areas and urban suburbs take the lead in making breakthroughs in the reform of institutional mechanisms". In other words, the urban areas will have to figure it out, and then it will be rolled out nationwide. By 2035, there is supposed to be a unified rural-urban land market, an inclusive financial services system, more or less equal levels of basic public services, and what the Chinese government call a modernization of agricultural and rural areas.

The Civil Code could not do this on its own. Rather, it outlined the idea of freehold changing, and made a new focus on the rules that govern behaviour. The code adds provisions on economic rural collectives and villages committees, among others, in order to allow rural residents to better participate in civil life. Part of this is saying what these committees will do. Another part is putting a price on land so that farmers who have settled in the city can return. Local governments "support them in voluntarily transferring the above rights and interests in return for compensation according to law." In other words, the Civil Code says who gets to decide compensation for land, and outlines the rules of how they should be paid. This will affect every budget, company, and household in the land.

What comes next?

The Civil Code will not come into force until January next year. In the mean time, all ministries, legislatures and local governments will need to fill in the blanks of what is unclear. For businesses and investors, now is the time to look at the Civil Code, determine which parts may affect operations or deployed capital, and take measures.

For those who watch where China is going, the Civil Code is momentous and yet curiously under-reported. It outlines how business, society, and the government are to get along. Expect to see more stories on this in the coming months.

Glossary of terms

A

AI	Artificial Intelligence
APAC	Asia Pacific
API	Application Programming Interface
APJ	Asia Pacific and Japan
APR	Annual Percentage Rate
ARPU	Average Revenue Per User
ARPPU	Average Revenue Per Paying User
ARR	Annual Recurring Revenue
ASEAN	Association of Southeast Asian Nations
AUM	Assets Under Management

B

B2B	Business to Business
B2C	Business to Consumer
BOD	Board of Directors
BVI	British Virgin Islands

C

C2C	Consumer to Consumer
CAGR	Compound Annual Growth Rate
CLA	Convertible Loan Agreement
CV	Curriculum Vitae

D

DAU	Daily Active Users
DACH	Deutschland, Austria & Switzerland
DD	Due Diligence
DMP	Data Management Platform
DPI	Distributions to Paid in Capital

E

EBITDA	Earnings Before Interest, Tax, Depreciation and Amortisation
ECB	European Central Bank
ELN	Equity Linked Notes
ESOP	Employee Stock Ownership Plan
EU	European Union

F

FAV	Fair Appraisal Value
FY	Financial Year

G

GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Product
GMV	Gross Merchandise Volume
GP	General Partner
GWP	Gross Written Premium

H

HIBOR	Hong Kong Interbank Offered Rate
HKMA	Hong Kong Monetary Authority
HoH	Half on Half
HR	Human Resources
HY	High Yield

I

IFRS	International Financial Reporting Standards
IG	Investment Grade
IPO	Initial Public Offering
IRR	Internal Rate of Return
IT	Information Technology
ITD	Inception to Date

J

JACI	J.P. Morgan Asia Credit Index Core
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K

KPI	Key Performance Indicator
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L

LP	Limited Partner
LTM	Last Twelve Months
LTV	Loan to Value Ratio

M

M&A	Merger and Acquisition
MAU	Monthly Active Users
MHE	Mid to High End
MOIC	Multiple on Invested Capital
MoM	Month on Month
MRR	Monthly Recurring Revenue
MSCI	Morgan Stanley Capital International
MSME	Micro, Small and Medium Enterprise
MTD	Month to Date

N

NAV	Net Asset Value
NPV	Net Present Value

O

O2O	Online to Offline
OEM	Original Equipment Manufacturer

P

P&C	Property and Casualty
P2P	Peer to Peer
PaaS	Platform as a Service
PARx	Portfolio at Risk more than x days
PMS	Property Management System

Q

QoQ	Quarter on Quarter
QTD	Quarter to Date

R

R&D	Research & Development
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S

SaaS	Software as a Service
SAFE	Simple Agreement for Future Equity
SFC	Securities and Futures Commission
SFO	Securities and Futures Ordinance
SI	Since Inception
SME	Small to Medium Enterprise
SOE	State-owned Enterprise
SPC	Segregated Portfolio Company
SPV	Special Purpose Vehicle

T

TER	Total Expense Ratio
TTV	Total Transaction Value

U

UCITs	Undertakings for Collective Investment in Transferable Securities
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V

VIE	Variable Interest Entity
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W

X

Y

YTD	Year to Date
YTM	Yield to Maturity
YoY	Year on Year

Z

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